TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1934

No. 22

IRVING TRUST COMPANY, AS TRUSTEE IN BANKRUPTCY OF OUTFITTERS OPERATING REALTY CO., INC., PETITIONER,

vs.

A. W. PERRY, INC.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

PETITION FOR CERTIORARI FILED APRIL 16, 1934.

CERTIORARI GRANTED MAY 14, 1934.

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IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

In the Matter of Outfitters Operating Realty Co., Inc. (a Delaware corporation), Bankrupt

Statement Under Rule XIII

This case comes up on appeal from an order of the United States District Court for the Southern District of New York confirming an order of the Referee in Bankruptcy. The order of the District Court from which this appeal is taken was entered on August 11, 1933.

The bankrupt herein is Outfitters Operating Realty Co., Inc., a Delaware corporation. It filed a voluntary petition in bankruptcy on September 30, 1932, and on that date, by an order entered in the United States District Court for the Southern District of New York, was adjudicated a bankrupt and the matter was referred to Hon. Irwin Kurtz, Referee in Bankruptcy.

The appellant is A. W. Perry, Inc., a corporation organized under the laws of the State of Massachusetts.

Attorneys for the appellant are Larkin, Rathbone & Perry.

The respondent is Irving Trust Company, a corporation [fol. 2] organized under the laws of the State of New York. The said Irving Trust Company was duly elected Trustee in Bankruptcy of the bankrupt herein on October 15, 1932, and on October 18, 1932, duly qualified and has since acted as such Trustee.

Counsel for said Trustee in Bankruptcy are Beekman, Bogue & Clark. Said counsel were appointed by an order of the Referee in Bankruptcy, dated October 19, 1932, and a supplemental order, dated November 3, 1932.

Proof of claim herein was filed by appellant on Mar. 29, 1933.

An order to show cause why the claim should not be disallowed and the proof of claim expunged was signed by the Referee on April 5, 1933, upon petition of the Trustee in Bankruptcy.

Said order to show cause came on for hearing before the Referee on April 18, 1933.

The order of the Referee disallowing the claim was entered June 1, 1933.

The petition for review was filed by the appellant on June 12, 1933.

The certificate of the Referee certifying the cause to the United States District Court for the Southern District of New York was signed on June 13, 1933.

The hearing before the United States District Court was on July 5, 1933.

The order allowing the appeal, and the citation, were signed by Hon. John M. Woolsey, United States District Judge, on September 6, 1933.

There has been no change of parties or attorneys herein.

Stipulation and order re Record on Appeal was filed September 14, 1933.

[fol. 3] IN UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF NEW YORK

In Bankruptcy. No. 55384

In the Matter of OUTFITTERS OPERATING REALTY CO., INC. (a Delaware corporation), Bankrupt

PETITION OF IRVING TRUST CO.

To the Honorable Irwin Kurtz, Referee in Bankruptcy:

The petition of Irving Trust Company, as Trustee in Bankruptcy herein, respectfully shows to the Court as follows:

On October 15, 1932, your petitioner was duly appointed and qualified as Trustee in Bankruptcy of the above named Bankrupt and is acting as said Trustee.

That there has been filed with this Court a proof of claim numbered 27, by A. W. Perry, Inc., setting forth an alleged claim of said A. W. Perry, Inc., against the bankrupt in the sum of $177,788.

Your petitioner objects to the allowance of said claim for the following reasons:

That said alleged claim is for damages for breach of a covenant to pay rent under a lease; that no part of said rent from non-payment of which said damages are alleged [fol. 4] to arise, was due and payable at the date when the petition in bankruptcy was filed herein; and that therefore the said claim is not provable in bankruptcy.

Your petitioner, accordingly, desires to have its objections to said claim heard and determined, and said claim reconsidered and re-examined in accordance with the applicable provisions of the Bankruptcy Act.

Wherefore, your petitioner respectfully requests that an order be entered herein,

Ordering that said Claimant appear before this Court at a time and place to be fixed by this Court to show cause, if any there be, why an order should not be made and entered herein disallowing and rejecting said claim, expunging the proofs of said claim hereinabove referred to and ordering that no dividend be paid thereon.

Dated April 5, 1933.

Irving Trust Company, as Trustee in Bankruptcy, by Joseph T. Stearns, Assistant Secretary. Beekman, Bogue & Clark, Attorneys and Solicitors for Irving Trust Company, Trustee in Bankruptcy of Outfitters Operating Realty Co., Inc. (Delaware), 15 Broad Street, Borough of Manhattan, New York, N. Y.

[fol. 5] *Duly sworn to by Joseph T. Stearns. Jurat omitted in printing.*

Affidavit of Service annexed.

[fol. 6] IN UNITED STATES DISTRICT COURT

[Title omitted]

ORDER TO SHOW CAUSE

Upon reading and filing the annexed ex parte petition of Irving Trust Company, Trustee in Bankruptcy of Outfitters Operating Realty Co., Inc., the bankrupt herein, verified April 5, 1933, and sufficient cause appearing therefor, it is,

on motion of Beekman, Bogue & Clark, attorneys and solicitors for said Trustee.

Ordered, that A. W. Perry, Inc. (hereinafter called "Claimant"), show cause, if any there be, before me at a hearing to be held at No. 15 Park Row, in the Borough of Manhattan, City and State of New York, on the 18 day of April, 1933, at 11 o'clock in the forenoon, or as soon thereafter as counsel may be heard, why an order should not be entered herein disallowing and rejecting the claim of the Claimant set forth in the proof of claim filed herein and numbered 27, expunging said proof of claim, and ordering that no dividend be paid thereon.

[fol. 7] Further Ordered, that due and timely service of this order to show cause be made by mailing a copy thereof, together with said petition of the Trustee, on or before April 6th, 1933, to the Claimant at the address of the Claimant appearing on said proof of claim, and by serving a copy of this order to show cause and petition on Larkin, Rathbone & Perry, Esqs., attorneys for Claimant, at their office at No. 70 Broadway, Borough of Manhattan, City, County and State of New York.

Dated New York, N. Y., April 5, 1933.

Irwin Kurtz, Referee in Bankruptcy.

[fol. 8] IN UNITED STATES DISTRICT COURT

[Title omitted]

POWER OF ATTORNEY AND PROOF OF DEBT

At Boston, in the District of Massachusetts, on the 28th day of March, A. D. 1933, came Winthrop I. Perry of Rockland, in the County of Plymouth, and State of Massachusetts, and made oath and says that:

1. He is acting Treasurer of the A. W. Perry, Inc., a corporation, incorporated by and under the laws of the State of Massachusetts and carrying on business at Boston, in the County of Suffolk, and State of Massachusetts, and that he is duly authorized to make this proof, and says that the said Outfitters Operating Realty Co., Inc., the person by whom a petition for adjudication of bankruptcy has been filed, was at and before the filing of said petition, and still

is, justly and truly indebted to said corporation in the sum of One Hundred Seventy-seven Thousand Seven Hundred Eighty-eight dollars; that the consideration of said debt is as follows: Damages for breach of covenant to pay rent under a lease, a copy of which is hereto annexed that [fol. 9] no note or judgment has been received by or in favor of this claimant upon said account unless otherwise set forth herein; that no part of said debt has been paid; that there are no set-offs or counterclaims to the same, and that there has been received no manner of security for said debt whatever.

Winthrop I. Perry.

Subscribed and sworn to before me this 28th day of March, A. D. 1933. Richard J. Walsh, Notary Public in and for the County of Suffolk and State of Massachusetts. (Notarial Seal.)

To Albert Stickney, Francis S. Bensel, and/or Theodore Pearson:

The Undersigned, A. W. Perry, Inc., a corporation duly organized under the laws of Massachusetts and having a usual place of business in Boston, in the County of Suffolk and State of Massachusetts, do hereby authorize you, or any one of you, to attend the meeting or meetings of creditors of the bankrupt aforesaid at a court of bankruptcy, wherever advertised or directed to be holden, on the day and at the hour appointed and notified by said court in said matter or at such other time and place as may be appointed by the court for holding such meeting or meetings, or at which meeting or meetings, or any adjournment or adjournments thereof may be held, and then and there from time [fol. 10] to time, and as often as there may be occasion for or in the name of the undersigned to vote for or against any proposal or resolution that may be then submitted under the acts of Congress relating to bankruptcy; and in the choice of trustee or trustees of the estate of said bankrupt, and for the undersigned to assent to such appointment of trustee, and with like powers to attend and vote at any other meeting or meetings of creditors, or sitting or sittings of the court, which may be held therein for any of the purposes aforesaid; also to accept any composition proposed by said bankrupt in satisfaction of his debts, and

to receive payment of dividends and of money due the undersigned under any composition, and for any other purpose in whatsoever interest of the undersigned, with full power of substitution, and the undersigned does hereby revoke any and all prior powers of attorney that may have been given by the undersigned.

In witness whereof, the name and seal of the undersigned is hereby affixed the 28th day of March, A. D. 1933.

A. W. Perry, Inc., by Winthrop I. Perry, Treas.

Signed, sealed and delivered in presence of Richard J. Walsh.

Acknowledged before me this 28th day of March, A. D. 1933. Richard J. Walsh, Notary Public in and for the County of Suffolk and State of Massachusetts. (Notarial Seal.)

[fol. 11] EXHIBIT TO PROOF OF DEBT

Lease

This Indenture, made the 28th day of January in the year nineteen hundred twenty-nine between A. W. Perry, Inc. hereinafter called the Lessor, and Lerner Stores Corp., a Delaware corporation, hereinafter called the Lessee,

Witnesseth: The lessor do- hereby grant, demise, and lease unto the Lessee the premises situated in Boston, Massachusetts, known and described as store and basement 459 Washington Street.

The lessee has the privilege of subletting the basement to the Wilbar Shoe Store or to the Ginter Company or to any other tenant not reasonably objectionable to the lessor.

Provided the premises are rented to the Wilbar Shoe Store or the Ginter Company the lessee has the privilege of connecting the basement with their premises. The lessee may make such improvements and alterations, including a new front, as it desires, said improvements not to be structural improvements.

The premises are to be used by the lessee for the sale of women's wearing apparel, shoes excepted.

The lessor shall not cancel this lease on account of fire unless its lease of the entire building is cancelled for the same cause.

Commencing January 1935 the lessee shall pay as additional rent 2/7th of all taxes assessed on the Dexter Building and land over and above the tax assessed for the year 1927, amounting to $45,750. This tax is to be paid on October 1st of each year. In no event shall the rent and taxes average over $45,000 per annum from January 1, 1935 to [fol. 12] the expiration of this lease.

To Have and to Hold the same to the Lessee for the full term of fifteen years and ten months from noon of the first day of March 1929.

The Lessee hereby covenant- and agree-, (except as herein otherwise provided) to pay rent for the said premises at the rate of Thirty-five thousand ($35,000) dollars per annum for the first ten months, Thirty-six thousand nine hundred forty-eight ($36,948) dollars per annum for five years, Thirty-eight thousand three hundred seventy-six ($38,376) dollars per annum for five years, and Thirty-nine thousand eight hundred and five ($39,805) dollars per annum for five years dollars yearly, by equal monthly payments of Twenty-nine hundred and sixteen 67/100 dollars for the first ten months, Three thousand and seventy-nine dollars for five years, Three thousand one hundred and ninety-eight dollars for five years and Three thousand three hundred and seventeen and 09/100 dollars for the last five years.

— dollars on the first day of each month so long as the Lessee shall hold hereunder and on the first day of each succeeding month thereafter the first monthly payment to be made on the first day of March 1929; to use the demised premises only for ——; also, to pay all water rates or charges; to keep the premises, including the glass, sidewalk Hyatt lights, water, steam and gas piping, and electric and all other fixtures and machinery, in or on the prem- [fol. 13] ises (admitted now to be whole and in good order), in the same condition as the same are in at the commencement of said term, or may be put in during the continuance thereof, reasonable use and wear and damage by fire or other unavoidable casualty only excepted; (to keep the sidewalks bordering on said premises free from snow and ice;) not to overload, damage or deface the premises; not to drill any holes therein, or post or place thereon any sign, placard, or awning, except by written assent of the Lessor; not to use the premises for the storage of any articles or

for any purpose which will increase the ordinary rates of insurance upon said building or its contents, and to pay all extra insurance, if any, caused to Lessor by the Lessee use of the premises; not to use the premises for the storage or sale of spirituous or intoxicating liquors, or for an eating house; not to carry on any trade or occupation on the premises, nor make any use thereof which shall be unlawful, improper, noisy or offensive, or contrary to any law, ordinance, or by-law governing the premises; to comply with all the requirements of the Boston Board of Fire Underwriters, and State and City Laws and regulations now or hereafter in force, and with all reasonable rules now or hereafter made by the Lessor for the care of said building; not to assign this lease nor underlet in whole or part, without the written consent of the Lessor; to make no addition or alteration to or upon the premises, without the written consent of the Lessor; to allow the Lessor at reasonable times to enter and examine the premises and make repairs, improvements, or alterations of the [fol. 14] granted premises, or other parts of its estate, if desired, the prosecution of which does not unreasonably impair the Lessee use and enjoyment; to allow the Lessor during the last three months of the term, in any reasonable manner to affix and keep on the premises notice or notices "To Let," or "For Sale," to save the Lessor harmless from all loss or damage occasioned by the use or misuse of water, or of the plumbing, steam-heating apparatus, gas or other fixtures, or by the bursting or leakage of any pipes, or by any nuisance made or suffered on the premises; to indemnify and save the Lessor harmless from all loss or damage to persons or property in or about the premises whether occasioned by the escape of water or otherwise; and, at the expiration of the term, to yield up to the Lessor the premises and all additions to and improvements of the same in condition as herein agreed. No charge shall be made by the Lessor for any steam heat furnished in or for use of elevators to or from the demised premises, all of which it is the intention of the Lessor to furnish in such manner and at such times as are usual in buildings of a similar class, but the Lessor shall not be liable for failure to furnish any of the same or for any loss or damage resulting from such failure. The Lessor reserves the right to transmit through the demised premises to or from

other parts of said building or of any adjoining building any agency for light, heat or power used in buildings of a similar class, and the Lessee covenants and agrees to purchase and take from the Lessor all the electric current used [fol. 15] by the Lessee upon the demised premises and to pay therefor in monthly installments, with the rent, at the rates charged by the Edison Electric Illuminating Co. of Boston for similar service under the same conditions.

All merchandise, furniture and property of every kind, which may be on or about the premises during the term, shall be at the sole risk and hazard of the Lessee.

No waiver of or assent by the Lessor to any breach of the Lessee covenants shall be deemed a waiver of any other or future breach whatsoever.

The Lessee waive all demand and notice on account hereof.

This Lease is made on condition that, in case the premises, or the estate of which they may form part, be in whole or part destroyed or damaged by fire, or other unavoidable casualty, or if said estate be in whole or part taken by public authority for any public purpose, this lease may, at the election of the Lessor, be terminated; provided, that, if the same be not so terminated, a just and proportionate part of the rent shall be suspended or abated until the premises shall have been put by the Lessor in as good condition as at the date of such damage or taking; and the Lessee hereby assigns to the Lessor any and all claims and demands for damages on account of such taking.

This Lease is made on condition, also that if the Lessee shall neglect or fail to perform or observe any of the covenants herein contained on the Lessee's part to be performed [fol. 16] or observed, and except the covenant for the payment of rent, such default shall not be cured within twenty days after written notice by Lessor to Lessee at its main office or if the estate hereby created shall be taken on execution or other process of law, or if any assignment shall be made of the Lessee's property for the benefit of creditors, or if a receiver, guardian, conservator, or other similar officer shall be appointed to take charge of any property of or to wind up the affairs of the Lessee, and such receiver or other officer be not removed within twenty days then and in either of the said cases the Lessor lawfully may, imme-

diately or at any time thereafter and without demand or notice, enter into and upon the demised premises or any part thereof in the name of the whole and repossess the same as of the Lessor's former estate, and expel the Lessee and those claiming through or under the Lessee, and remove the effects of both or either (forcibly, if necessary) without being deemed guilty of any manner of trespass and without prejudice to any remedies for arrears of rent or preceding breach of covenant, and upon entry as aforesaid the Lessee's estate shall end, and, in the event of any such termination or of termination under statute for default of the Lessee, the Lessee will pay to the Lessor, as damages, a sum which at the time of such termination represents the difference between the rental value of the premises and the rent and other payments herein named for the residue of the term; and, for the more effectual securing to the Lessor of the rent and other payments herein pro-
[fol. 17] vided, it is agreed as a further condition of this lease that the filing of any petition in bankruptcy or insolvency by or against the Lessee shall be deemed to constitute a breach of this lease, and thereupon, ipso facto and without entry or other action by the Lessor, this lease shall become and be terminated; and, notwithstanding any other provisions of this lease, the Lessor shall forthwith upon such termination be entitled to recover damages for such breach in an amount equal to the amount of the rent reserved in this lease for the residue of the term hereof less the fair rental value of the premises for the residue of said term.

And the Lessor covenant and agree that the Lessee, paying the rent as aforesaid, and performing the covenants herein contained, shall peaceably hold and enjoy the premises without hindrance or interruption, except as herein provided.

The words "Lessor" and "Lessee" wherever used in the foregoing instrument, shall include legal representatives and assigns, and the covenants of the Lessees are the joint and several obligations of each party signing as Lessee.

In witness whereof, the said parties have hereunto, and to a duplicate hereof, set their hands and seals the day and year first above written.

A. W. Perry, Inc., H. G. Perry, Pres. (L. S.).
Lerner Stores Corporation (L. S.), by Joseph J. Lerner, Pres. (Seal.)

[fol. 18] STATE OF NEW YORK,
County of New York, ss:

On this 26th day of March, 1929, before me appeared Joseph J. Lerner, to me personally known, who, being by me duly sworn, did say that he is the President of Lerner Stores Corporation, and that the seal affixed to said instrument is the corporate seal of said corporation, and that said instrument was signed and sealed in behalf of said corporation by authority of its board of directors, and said Joseph J. Lerner acknowledged said instrument to be the free act and deed of said corporation.

J. H. Hersch, Notary Public, State of New York. New York Co. Clerk's No. 598. New York Co. Reg. No. O-798. Commission Expires March 30, 1930. (Seal.)

[fol. 19] IN UNITED STATES DISTRICT COURT

LETTER FILING PROOF OF CLAIM

March 29, 1933.

Hon. Irwin Kurtz, Referee in Bankruptcy, 15 Park Row, New York City

In the Matter of Outfitters Operating Realty Co., Inc., Bankrupt—No. 55384

DEAR SIR: On behalf of our client, A. W. Perry, Inc., we file with you herewith its proof of claim in the above matter in the amount of $177,788, and its power of attorney to Albert Stickney, Francis S. Bensel and/or Theodore Pearson, attached to which is photostatic copy of the lease referred to in the proof of claim.

By the filing of this proof of claim, A. W. Perry, Inc., does not waive but reserves all rights and claims against all persons, firms and corporations.

Will you be good enough to acknowledge receipt of the enclosures by stamping the enclosed carbon copy of this letter and returning it by the bearer.

Very truly yours, (Sgd.) Larkin, Rathbone & Perry.

TP:HL.

Enclosures.

Stamped—In re Outfitters Operating Realty (Del.) Received above proof of claim and filed the same this 29 day Mar., 1933.

Irwin Kurtz, Referee in Bankruptcy

[fol. 20] In United States District Court, Southern District of New York

In Bankruptcy. No. 55384

In the Matter of Outfitters Operating Realty Co., Inc., a Delaware Corporation, Bankrupt

Hearing of April 18, 1933

New York, April 18, 1933,
11:15 o'clock A. M.

Before Irwin Kurtz, Esq., Referee

Hearing on order to show cause to disaffirm claim designated as No. 27.

Proceeded pursuant to notice.

Appearances:

Messrs. Beekman, Bogue & Clark, attorneys for the Trustee, by John A. McNaughton and Daniel James, Esqs., of counsel.

Messrs. Larkin, Rathbone & Perry, attorneys for A. W. Perry, Inc., claimant, by Theodore Pearson, Esq., of counsel.

Robert P. Levis, Esq., attorney for Lerner Stores Corporation of Maryland.

Bertram L. Marks, Esq., attorney for the bankrupt.

[fol. 21] Mr. McNaughton: This is a motion made for an order disallowing and rejecting the claim of A. W. Perry, Inc., filed in the sum of $177,788 for alleged damages for breach of covenant to pay rent under lease.

(Informal discussion off the record.)

Mr. Levis: The objection of the trustee to the claim of A. W. Perry, Inc., addresses itself solely to the provability of the claim at the present time.

It is stipulated that in case the Referee shall find that the claim is a provable claim, the question of the amount at which it shall be allowed is reserved and the parties may thereafter offer testimony liquidating the amount, if any.

The Referee: Is that stipulation satisfactory?

Mr. Pearson: Yes, on the understanding of the question I raised before, that it is without prejudice to whatever rights the claimant may have by virtue of any prima facie case made out by the filing of the proof of claim.

(Argument by Mr. McNaughton, followed by general discussion off the record.)

The Referee: Do you want to submit a memorandum in opposition?

Mr. Pearson: Yes, I think that would be desirable.

The Referee: How much time do you want?

Mr. Pearson: How would next Monday do?

The Referee: All right, you serve a copy of your memorandum on your opponent by April 24th.

Mr. Pearson: That is on Mr. McNaughton?

The Referee: Yes.

[fol. 22] Mr. Levis, do you want to submit a memorandum in addition to the memorandum served by the trustee?

Mr. Levis: I will serve my friend also by the 24th; we will simply exchange.

The Referee: Do you want time to reply, Mr. McNaughton?

Mr. McNaughton: I should judge about three days.

The Referee: All right, April 27th for reply.

Thereupon, at 11:20 o'clock, A. M., the matter was adjourned as follows: Claimant's memorandum to be served by April 24, 1933; reply memorandum to be served by April 27, 1933.

[fol. 23] IN UNITED STATES DISTRICT COURT

[Title omitted]

DECISION

This is an application by the Irving Trust Company, as Trustee herein, for an order to reject and disallow the claim herein of A. W. Perry, Inc. (hereinafter called the

Claimant), in the sum of One hundred seventy-seven thousand seven hundred and eighty ($177,780) Dollars, as "damages for breach of a covenant to pay rent under a lease." The Trustee maintains that this claim is, in fact, for the payment of future rent, and therefore not provable in bankruptcy.

It appears that on January 28th, 1929, the claimant and the Bankrupt entered into a lease covering a store and basement in premises located at 459 Washington Street, Boston, Massachusetts, for a term of fifteen (15) years and ten (10) months, from March 1st, 1929, at a graded rental commencing at Thirty-five thousand ($35,000) Dollars per annum. The clause of the lease upon which the claim herein is based is, as follows:

[fol. 24] "* * * *for the more effectual securing to the lessor of the rent* and other payments herein provided, it is agreed as a further condition of this lease that the filing of any petition in bankruptcy or insolvency at or against the lessee shall be deemed to constitute a breach of this lease, and thereupon *ipso facto* and *without any entry* or other action by the Lessor, this lease shall become and be terminated; and notwithstanding any other provisions of this lease, *the Lessor shall forthwith upon such termination be entitled to recover damages for such breach in an amount equal to the amount of the rent reserved in this lease for the residue of the term hereof less the fair rental value of the premises for the residue of said term.*" (Italics mine.)

After the making of this lease the Bankrupt entered into the possession of the demised premises, paid the rent therefor, and on September 30th, 1932 was duly adjudicated a Bankrupt—at the time of the adjudication there was no rent due.

The Trustee's application to reject this claim herein rests entirely upon the legal effect to be given in bankruptcy to the ipso facto provisions of the said clause of the lease. In determining this question it may be well to point out a landlord's rights against a tenant both at common law as well as in bankruptcy in the absence of any special clause in the lease. Undoubtedly, the limited rights and remedies of a landlord under such circumstances caused the insertion of this clause in the lease herein.

At common law, an abandonment of premises by a tenant [fol. 25] does not give a landlord an immediate action for damages based upon the future rent of the term. In the absence of a special covenant, a landlord upon such abandonment may at his option (1) allow the premises to remain vacant and recover from the tenant as the rent accrues or (2) enter and terminate the contract, accepting a surrender and thereby giving up any rights against the tenant for future rent, or (3) sublet the premises for the benefit of the tenant and recover for any loss incurred when the term has expired.

Thus, a Landlord at common law has a claim for damages for the total amount thereof whether the premises are permitted to remain vacant or relet for the tenant, but as pointed out such claim does not mature until the expiration of the term—(in this case such expiration is thirteen [13] years and [3] months after the adjudication). Moreover, the amount of a Landlord's damages upon such abandonment of premises is contingent and uncertain and, of course, can only be ascertained at the end of the term. Consequently, a Landlord upon the abandonment of the premises because of the bankruptcy of a tenant could only prove a claim in bankruptcy for the amount of the rent which had accrued prior to adjudication and had no claim for the future accruing rent.

In order to overcome this situation, the Landlords thereafter inserted in leases, various special covenants known as indemnification and damage clauses. These provisions, however, did not result in much assistance to landlords upon a tenant's bankruptcy. Although these clauses [fol. 26] usually provide that in the event of bankruptcy, that the landlord could re-enter the premises on his own account and hold the tenant for damages or for loss as stated in the covenant of indemnification—the amount, however, of such damages or such loss ordinarily could only be ascertained at the end of the term. Moreover, these special clauses were ineffectual in bankruptcy for the further reason that the lease pursuant to such clauses were terminated only by the re-entry of the landlord, which occurred after bankruptcy, therefore as the landlord's claim for future rent by way of damages or otherwise did not arise at the time of the adjudication, such a claim again was not provable in bankruptcy.

Landlords after these experiences commenced to insert in leases a new kind of provision known as the ipso facto clause. Such a clause was considered by the Supreme Court of the United States in Kothe v. R. C. Taylor Trust, 280 U. S. 24; the lease therein provided that the filing of a petition in bankruptcy by the tenant would ipso facto terminate the lease, and that upon such termination the landlord would be entitled to recover damages "equal to the amount of the rent reserved in the lease for the residue of the term." At the time of the adjudication, the lease had only two more years to run. Upon the bankruptcy of the tenant, the landlord re-entered the premises, terminated the lease and filed a claim for damages for the rent reserved for the said two years of the balance of the term. In reference to such claim, the Supreme Court stated:

The parties were consciously undertaking to contract for [fol. 27] payment to be made out of the assets of a bankrupt estate—not for something which the lessee personally would be required to discharge. He, therefore, had little, if any, immediate concern with the amount of the claim to be presented; most probably that would affect only those entitled to share in the proceeds of property beyond his control.

"*The broad purpose of the Bankruptcy Act is to bring about an equitable distribution of the bankrupt's estate among creditors holding just demands based upon adequate consideration.* Any agreement which tends to defeat that beneficent desig n must be regarded with disfavor. Considering the time which the lease here involved had to run, nothing else appearing, it seems plain enough that the real design of the challenged provision was to insure to the lessor preferential treatment in the event of bankruptcy. The record discloses no circumstance sufficient to support a contrary view. *If the term were much shorter, or there were facts tending to disclose a proper purpose,* the argument in favor of the lessor would be more persuasive." (Italics mine.)

The Landlord herein by the instant clause of the lease apparently endeavored to overcome the effect of the decision in the Kothe case, by eliminating the objectional rent-acceleration damage feature in the ipso facto clause therein, and by inserting in place thereof the provisions herein, that

upon the bankruptcy of the tenant that the Landlord should be forthwith entitled to receive ipso facto damages "in an amount equal to the amount of rent reserved in this lease for the residue of the term hereof, less the fair rental value [fol. 28] thereof, for the residue of the said term."

Therefore, it becomes important to test the specific damage provision herein with the principle enunciated by the Supreme Court in the Kothe case, to determine whether the instant clause falls within the broad purposes of the Bankruptcy Act, and whether it "tends to bring about an equitable distribution of the Bankrupt's estate herein among the creditors holding just demands based upon adequate consideration." In so applying this test, various elements must be taken into consideration.

Therefore, in view of the long period of time, namely, over thirteen years that the lease herein had still to run at the time of the adjudication, and for which period of time damages are claimed—it is important to note the significant statement by the Supreme Court in the Kothe case concerning the short period of two years involved therein, which was, as follows:

"*If the term were much shorter* or there were facts tending to disclose a proper purpose, the argument in favor of the lessor would be more persuasive." (Italics mine.)

It is also necessary to consider the further statement by the Court, "that if there were facts tending to disclose a proper purpose the argument in favor of the lessor would be more persuasive." Accordingly, the facts and circumstances of the lease must be examined to ascertain the purpose of the ipso facto clause herein, to determine whether it penalizes other creditors of the tenant, and therefore whether it comes within the purposes of the Bankruptcy Act, enunciated as aforesaid in the Kothe case.

[fol. 29] Thus, at the very outset it appears that by the express language of the clause herein, that the ipso facto provision was inserted "for the more effectual securing to the lessor of the rent." Concededly, future rent as such is not provable in bankruptcy. Under such circumstances, can the security clause for the payment of such future rent be regarded with favor as coming within the beneficent designs

of the Bankruptcy Act, so that it may be used as a basis for a provable claim in bankruptcy? Clearly, the purpose of this clause was to make a non-provable claim for future rent or for future damages, if any, into a provable claim. It must be borne in mind that at the time of the adjudication herein there was no rent and that no such default occurred until after adjudication.

The claim herein for damages is predicated solely upon the termination of the lease, pursuant to the clause of the lease herein providing for such termination upon the bankruptcy of the tenant. The legal effect, therefore, sought in Bankruptcy of this ipso facto clause is to convert, at the time of the adjudication herein, the Landlord's unaccrued and future rental into an immediately provable claim for damages, and this to be based upon the difference between the rent reserved in the lease and the supposed present rental value for each year of the remaining thirteen years of the lease. Obviously, such a calculation of damages cannot be made with any degree of accuracy. Such a clause can only result in unfairness to other creditors. The claim presented herein in the huge sum of One hundred seventy-seven thousand, seven hundred and eighty ($177,780) Dol- [fol. 30] lars prevents the assets of the estate from being distributed equitable and ratably among all the ordinary creditors.

After all, the persons to be considered primarily herein are the creditors. The Landlord under the circumstances in this case is not on an even basis with the ordinary creditors. The Landlord is not in the same position with other creditors "holding just demands based upon adequate consideration," and accordingly should not be entitled to an equitable distribution of the Bankrupt's estate herein with such other creditors. This is so because the ordinary creditors have parted with their merchandise, their consideration, and naturally their claims can only be satisfied from the assets which they have contributed or into which their assets have been converted by the Bankrupt and still remain in the estate for distribution. The Landlord, on the other hand, by the very ipso facto clause herein, having terminated the lease, has regained possession of its property, and the consideration of the tenant's obligation for rent—the demised premises herein—has been returned to him.

The Landlord therefore, is in a different situation than the ordinary creditor in this case. Such creditors indeed, would be penalized if the landlord would be permitted, under the guise of this claim, to convert the future rent herein into a present damage claim provable in bankruptcy. Mere language should not be able to create a charge against creditors which otherwise does not exist. Merely changing the label and calling the future unaccrued rent herein immediate damages, ipso facto, should not bring about such an undesirable result to the serious prejudice of the other credi-
[fol. 31] tors herein who hold "just demands based upon adequate consideration" as pointed out heretofore.

Obviously, when the clause herein was inserted the landlord knew that in the event of bankruptcy, it was immaterial to the tenant what claims were provable thereafter against its estate. The tenant corporation was not concerned with its creditors in the event of the bankruptcy and, of course, cared little about the size of the claim that the landlord would assert against the Bankrupt estate.

If the ipso facto damage clause herein is upheld and applied to the lease herein for the balance of the term of thirteen (13) years and three (3) months, the principle thereof would have to be applied to all cases whether the residue of the term be twenty years, forty years or more. It can readily be seen that under such circumstances the amount of damages that could be assessed against the creditors of the estate could result in practically wiping out the rights of all ordinary creditors and defeating the very purpose of the Bankruptcy Act as stated by the Court in Kothe v. R. C. Taylor Trust, (supra). Clearly, such is not the intent or purpose contemplated by the Bankruptcy Act.

Moreover, as heretofore stated, the damages if any, of the landlord could only properly and accurately be ascertained at the expiration of the term. At the time of the adjudication, it was impossible with any degree of certainty to ascertain the fair rental value of the subsequent many years of the term herein. The total amount of rent received for the balance of the term could greatly equal
[fol. 32] or even exceed the amount reserved in the lease and thus would accordingly entirely eliminate the amount of damages calculated by the Landlord under the clause

herein. The measure of damages provided herein is therefore too speculative and conjectural.

This feature as to uncertainty of such damages was stressed and pointed out in the leading case of Roth & Appel, 181 Fed. 667; the lease therein provided:

"In case the lessee is declared bankrupt, the lease shall terminate and the lessor has a right to re-enter, in which case the lessee agrees as part consideration hereof, that it, and its legal representatives, will pay to the lessor and his legal representatives on the first day of each and every month, as upon rent dates, the difference between the rents and the sums reserved and agreed to be paid by the lessee and those otherwise reserved or with due diligence collected, on account of rent of the demised premises for the preceding month, up to the end of the term, remaining at the time of the entry. After bankruptcy the landlord reentered and re-let the premises for the balance of the term at a lower rental."

The Supreme Court therein, in expunging the lessor's claim for an alleged deficiency, stated:

"(2) *In case the lease was terminated, it was uncertain whether there would be any loss in rents. If the rent received by the landlord from the new tenant equaled or exceeded that stipulated in the lease, there would be no loss, and, consequently, no foundation for any claim upon the indemnity covenant*" (Italics mine.)

[fol. 33] The Court in Roth & Appel pointed out that even after re-entry by the Landlord that no immediate cause of action arose; that the landlord's claim for damages only matured when the time for the ascertainment of the deficiency arrived and provided that there was a deficiency at that time. Thus, under the doctrine of this case, it seems that even upon the re-entry and re-letting by a landlord prior to bankruptcy, that a claim for deficiency arising after bankruptcy would not be provable because of the existence of a deficiency at the time for ascertainment under the covenant would still be contingent at the time of the filing of the petition.

The doctrine of Roth & Appel has just been reaffirmed in this district and in this circuit, in the matter of In re

Wise Shoe, Inc., 22 A. B. R., 125 affirmed Second Circuit (April 4th, 1933). Judge Patterson of the District Court in his opinion also stressed the uncertainty and contingency of damage claims for rent accruing in the future by stating:

"* * * Such a claim is said to be to- uncertain at the time of bankruptcy in two respects, first as to whether the landlord will re-enter and thus terminate the lease, and second, as to whether any loss in rents will actually come about. The second uncertainty or contingency is found also in cases like the present one, where the landlord had declared the lease terminated prior to bankruptcy but had not then relet the premises. *It cannot be predicated at the time of the bankruptcy whether there will be any loss.* Hence it is held that in such a case a claim based upon the tenant's agreement to indemnity is not provable" (In re [fol. 34] Service Appliance Co. [D. C. N. Y.] 15 Am. B. R. [N. S.] 478, 39 F. [2nd] 632; In re Goldberg [D. C. N. Y.], 18 Am. B. R. [N. S.] 332, 52 F. [2nd] 156; In re Hubbard [D. C. N. Y.], 20 Am. B. R. [N. S.] 612, 57 F. [2nd] 213).

In re 20th Century Millinery Exchange, S. D. N. Y. 41 F. (2nd) 237 is "*not* an authority squarely in point," as contended for by the claimant. The bankrupt therein was the lessee of certain premises. The lease thereof provided that if the lessee (bankrupt) should be adjudicated a bankrupt or should file a petition in bankruptcy, that

"* * * 'such event shall be deemed to constitute a breach of this lease and thereupon ipso facto and without entry or without other action by the lessor, this lease shall become and be terminated.'"

The lessee (bankrupt) after the making of this lease with the landlord made a sub-lease with the claimant therein at a lower rental, by which agreement with the claimant it was provided:

"'It is understood and agreed that if the present lessor (meaning the bankrupt) commits any breach of covenant in the original lease (meaning between it and its lessor) and by reason of said breach the present lessee (namely the claimant) is compelled to take over said original lease from said Charles Ulin and assume a greater rent than is stipulated in its present lease, the said present lessor (bank-

rupt) shall be obligated to pay the present lessee as its damages the difference between the rent set forth in its [fol. 35] present lease and the original lease (Exhibit A).'"

As a result of the bankruptcy the claimant as sublessee was required to enter into a new agreement with the landlord, and leased the premises at a higher rate, namely, at the same rate of rent which the bankrupt had been paying. The sublessee (claimant) thereupon filed a claim for the difference between the rent reserved in the sublease with the bankrupt and the new rent to be paid to the new landlord. The claim was sustained, and properly so, the Court stating:

"It is not a claim for rents to accrue, which, in this circuit, is not provable, in re Roth & Appel (C. C. A.), 181 F. 667, 31 L. R. A. (N. S. 270), unless the default in the lease has occurred, and the liability has become fixed prior to the filing of the petition (In re Mullings Clothing Co. [C. C. A.], 238 F. 58). It is similar to an obligation to indemnify a surety where the liability has become fixed (Williams v. U. S. Fidelity Co., 236 U. S. 549, 35 S. Ct. 289, 59 L. ed. 713). * * *"

Clearly, the main lease therein having terminated upon the bankruptcy, the claimant's sublease naturally fell also, and the claimant pursuant to the agreement of sublease with the bankrupt immediately had a fixed and absolute claim for damages against the bankrupt in an amount for the difference in the rent stipulated in the sublease made as aforesaid with the bankrupt, and the amount that the claimant was required to pay the landlord as a result of the bankruptcy of the lessee. This was a specific amount and [fol. 36] was fixed in the sublease agreement between the claimant and the bankrupt. There was nothing speculative, uncertain or contingent in regard thereto whatever and represented the claimant's actual fixed loss sustained. Thereupon, upon the facts this decision has no application to the facts in the instant case.

Clearly, as pointed out in the Roth & Appel case and Wise Shoe (supra) and similar controlling authorities in bankruptcy, the method of calculation of the damages provided for in the instant ipso facto clause herein, makes such damages neither fixed nor certain. On the contrary,

the amount thereof is contingent and uncertain both as to existence and as to amount.

In view of all the foregoing, the landlord's claim herein should not be permitted to interfere with the equitable and ratable distribution of the bankrupt's assets among the aforesaid creditors, who are entitled to the protection of the Bankruptcy Act; the allowance of this claim based upon this unreasonable provision for damages for the balance of the term of thirteen (13) years and three (3) months, would minimize the distribution of the assets to such creditors, and would result in penalizing and depriving them of the beneficent design of the Bankruptcy Act. Accordingly, the Trustee's application to disallow and expunge the landlord's claim is granted.

Submit order on two days' notice.

Dated New York, May 25th, 1933.

Irwin Kurtz, Referee in Bankruptcy.

[fol. 37] IN UNITED STATES DISTRICT COURT

[Title omitted]

ORDER DISALLOWING CLAIM

Upon reading and filing the petition of Irving Trust Company, Trustee in Bankruptcy herein, verified the 5th day of April, 1933, the order to show cause filed herein dated the 5th day of April, 1933, and the affidavit of Jack Lisa, verified the 6th day of April, 1933, from which it appears that said petition and order were duly served as therein provided, and the matter having duly come on to be heard before this Court on the 18th day of April, 1933, at eleven o'clock in the forenoon, in pursuance of the provisions of said order to show cause, and after hearing counsel for the interested parties,

It is, on motion of Beekman, Bogue & Clark, attorneys for the Trustee herein,

[fol. 38] Ordered that the claim set forth in the proof of claim numbered 27 filed herein by A. W. Perry, Inc., be, and it hereby is disallowed and rejected that said proof of claim be, and it hereby is, expunged and that no dividend be paid thereon.

Dated New York, N. Y., June 1, 1933.

Irwin Kurtz, Referee in Bankruptcy.

We, the undersigned, attorneys for A. W. Perry, Inc., waive notice of settlement of the above proposed order.

Larkin, Rathbone & Perry.

[fol. 39] IN UNITED STATES DISTRICT COURT

[Title omitted]

PETITION OF A. W. PERRY, INC., FOR REVIEW OF REFEREE'S ORDER

Petitioner is a creditor of the above-named bankrupt and as such was a party to the following certain proceedings in said bankruptcy pending before Irwin Kurtz, Esq., as the Referee in Bankruptcy in charge thereof, to wit, the petition of Irving Trust Company, Trustee of the above-named bankrupt, for an order disallowing and rejecting your petitioner's claim, expunging your petitioner's proof of claim herein and ordering that no dividend be paid thereon.

Following the hearing thereof, a final order dated June 1, 1933, was made by said Referee, as follows, to wit: "That the claim set forth in the proof of claim numbered 27 filed herein by A. W. Perry, Inc., be, and it hereby is, disallowed and rejected, that said proof of claim be, and it hereby is, expunged and that no dividend be paid thereon."

[fol. 40] Said order is erroneous in this, that by reason of the provisions of the lease executed by the bankrupt under which your petitioner's claim is made, your petitioner's claim for damages thereunder is a provable claim herein under the acts of Congress relating to bankruptcy, and that said order should not have been made.

Wherefore, petitioner prays that said order be reviewed and reversed, and that he be restored to all things he has lost by reason of said order.

June 12, 1933.

A. W. Perry, Inc., Petitioner, by Larkin, Rathbone & Perry, Attorneys for A. W. Perry, Inc., 70 Broadway, Borough of Manhattan, New York, N. Y.

[fol. 41] IN UNITED STATES DISTRICT COURT

[Title omitted]

REFEREE'S CERTIFICATE OF REVIEW

To the Honorable Judges of the United States District Court, for the Southern District of New York:

I, Irwin Kurtz, Referee in Bankruptcy herein, do hereby certify:

1. On June 1st, 1933 an order was made which granted the application of the Irving Trust Company, as Trustee herein, to disallow and reject the proof of claim of A. W. Perry, Inc. (hereinafter called Claimant) in the sum of One hundred seventy-seven thousand seven hundred and eighty ($177,780) Dollars "as damages for breach of a covenant to pay rent under a lease." This order was based upon the ground that the said claim was in fact for the payment of future rent and as such not provable in bankruptcy.

2. On June 12th, 1933, the Claimant-Petitioner herein feeling aggrieved thereat, filed a Petition for Review.

3. The error complained of is that the claim for damages [fol. 42] under the lease herein is provable in bankruptcy.

4. A summary of the proceedings, the contentions of both the Claimant-Petitioner and the Trustee, and the conclusions of the Referee are fully set forth in the decision dated May 25th, 1933, to which the Court is respectfully referred as to the legal question presented.

5. I hand up herewith the following:

(a) Petition for Review.
(b) Referee's Decision dated May 25th, 1933.
(c) Order sought to be reviewed.
(d) Application of Trustee and Proof of Claim.

Dated New York, June 13th, 1933.

Irwin Kurtz, Referee in Bankruptcy.

This certificate will be on the Bankruptcy Motion Calendar for hearing in the District Court on Wednesday, June 21st, 1933, at 10:30 A. M.

Notice thereof by mail has been given to:

Messrs. Beekman, Bogue & Clark, Attorneys for Trustee, 15 Broad Street, New York City.

Messrs. Larkin, Rathbone & Perry, Attorneys for Claimant-Petitioner, 70 Broadway, New York City.

[fol. 43] IN UNITED STATES DISTRICT COURT

MEMORANDUM OF JUDGE GODDARD

The order of the Referee is in accordance with the decisions and the reasoning of In re Roth & Appel, 181 Fed. 667, and as yet unreported decisions of the Circuit Court of Appeals of this Circuit filed July 18, 1933 in re Brown, et al. v. Irving Trust Company, Manhattan Properties, Inc., v. Irving Trust Company, and in re Metropolitan Chain Stores, Inc. (Claim of Peter Malavazos, et al.)

The order of the Referee is affirmed. Settle order on notice.

July 25, 1933.

Henry W. Goddard, U. S. D. J.

[fol. 44] IN UNITED STATES DISTRICT COURT

In Bankruptcy. No. 55384

In the Matter of OUTFITTERS OPERATING REALTY CO., INC. (Delaware), Bankrupt

ORDER CONFIRMING REFEREE'S ORDER—Aug. 8, 1933

Present: Hon. Henry W. Goddard, Judge.

A. W. Perry, Inc., having filed on June 12, 1933, a petition to review, vacate and set aside an order entered herein by the Referee, dated June 1, 1933, expunging a claim heretofore filed herein by the said A. W. Perry, Inc., and said claim having come on for hearing before the Court on the 5th day of July, 1933.

Now, upon reading and filing the said petition of the aforesaid A. W. Perry, Inc., and on certificate of Hon. Irwin

Kurtz, Referee herein dated June 13, 1933, and all of the papers and proceedings certified to the Court in the said certificate of the Referee, and after hearing Mr. Thomas F. Dougherty, of counsel for said A. W. Perry, Inc., in support of said petition, and Mr. Edward K. Hanlon, of counsel for Irving Trust Company, as Trustee in Bankruptcy herein, in opposition thereto, and after due deliberation, it is, on motion of Beekman, Bogue & Clark, attorneys for [fol. 45] the Trustee in Bankruptcy herein,

Ordered, that the said petition for review of A. W. Perry, Inc., be, and the same hereby is dismissed; and it is further

Ordered, that the said order of the Referee, dated June 1, 1933, be and the same hereby is in all respects, confirmed.

Henry W. Goddard, U. S. D. J.

We hereby waive notice of settlement of the foregoing order.

Dated August 7, 1933.

Larkin, Rathbone & Perry, Attorneys for Petitioners.

[fol. 46] In United States District Court

[Title omitted]

Petition for Appeal

A. S. Perry, Inc., feeling itself aggrieved by the order made herein on August 8, 1933, and entered herein on or about August 11, 1933, confirming in all respects the order made herein by Hon. Irwin Kurtz, dated June 1, 1933, wherein the Honorable Referee disallowed and rejected the claim of said A. W. Perry, Inc., and directed that the same be expunged and that no dividend be paid thereon, and dismissing the petition of A. W. Perry, Inc., dated June 12, 1933, for an order to review the said order of the Referee herein, does hereby appeal from the said order made on August 8, 1933, and entered herein on or about August 11, 1933, to the United States Circuit Court of Appeals for the Second Circuit, for the reasons specified in the assignment of errors which is filed herewith, and prays that this appeal be allowed, and that citation issue as provided by law, and that a transcript of the record, proceedings and papers

upon which said order was made, duly authenticated, may [fol. 47] be sent to the United States Circuit Court of Appeals for the Second Circuit.

And your petitioner further prays that the proper order touching the security to be required of it to perfect its appeal be made.

Dated New York, N. Y., September 5, 1933.

Larkin, Rathbone & Perry, Attorneys for A. W. Perry, Inc., Petitioner, Office and Post Office Address: No. 70 Broadway, Borough of Manhattan, New York, N. Y.

ORDER ALLOWING APPEAL

Petition granted, and the appeal allowed, upon giving bond conditioned as required by law in the sum of Two Hundred and Fifty ($250) Dollars.

Dated September 6, 1933.

Woolsey, United States District Judge.

Bond. Bond in the sum of $250.00 was filed on Sept. 11/33.

[fol. 48] IN UNITED STATES DISTRICT COURT

[Title omitted]

ASSIGNMENT OF ERRORS

Now comes the petitioner, A. W. Perry, Inc., in connection with its petition for appeal herein, and makes the following assignment of errors which it avers were committed by the Court in the rendition of its order against it, and upon which it relies to reverse the order entered herein as appears of record:

1. That the District Court erred in confirming the order of Honorable Irwin Kurtz, Referee in Bankruptcy herein, dated June 1, 1933, disallowing and rejecting the claim heretofore filed herein and ordering that said claim be expunged and that no dividend be paid thereon.

2. That the District Court erred in refusing to reverse said order of Honorable Irwin Kurtz, the Referee herein, made June 1, 1933.

3. The District Court erred in refusing to hold that, by reason of the provisions of the lease executed by the bankrupt, under which the claim of A. W. Perry, Inc., was made, said claim of A. W. Perry, Inc., for damages there-
[fol. 49] under is a provable claim herein under the Acts of Congress relating to bankruptcy.

4. The District Court erred in dismissing the petition of A. W. Perry, Inc., dated June 12, 1933, for an order reviewing the said order of Honorable Irwin Kurtz, the Referee herein.

5. That the order appealed from is contrary to law.

Wherefore, appellant prays that the order of the said District Court of the United States for the Southern District of New York may be reversed and remanded with directions to proceed in accordance with law.

Dated New York, September 5, 1933.

Larkin, Rathbone & Perry, Attorneys for A. W. Perry, Inc., Creditor-Appellant, Office and Post Office Address, No. 70 Broadway, Borough of Manhattan, New York City.

[fol. 50] Citation in usual form omitted in printing.

[fol. 51] IN UNITED STATES DISTRICT COURT

STIPULATION AS TO TRANSCRIPT OF RECORD

It is hereby stipulated and agreed that the foregoing is a true transcript of the record of the said District Court in the above entitled matter as agreed upon by the parties.

Dated Oct. —, 1933.

Larkin, Rathbone & Perry, Attorneys for Appellant.
Beekman, Bogue & Clark, Attorneys for Appellee.

Clerk's certificate to foregoing transcript omitted in printing.

[fol. 52] UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

In re OUTFITTERS OPERATING REALTY CO., INC. (a Delaware Corporation), Bankrupt

A. W. PERRY, INC., Appellant,

against

IRVING TRUST COMPANY, Trustee, Appellee

Before L. Hand, Swan, and Chase, Circuit Judges

Appeal from an Order in Bankruptcy of the District Court for the Southern District of New York Expunging the Claim of a Landlord

Thomas F. Dougherty for the appellant.
John A. McNaughton for the appellee.

L. HAND, Circuit Judge:

This appeal raises the provability in bankruptcy of the claim of a landlord under a covenant in a lease which read as follows: "* * * for the more effectual securing to the Lessor of the rent and other payments herein provided, it is agreed as a further condition of this lease that the filing of any petition in bankruptcy or insolvency by or against the Lessee shall be deemed to constitute a breach of this lease, and thereupon, ipso facto, and without entry or other action by the Lessor, this lease shall become and be terminated; and, notwithstanding any other provisions [fol. 53] of this lease, the Lessor shall forthwith upon such termination be entitled to recover damages for such breach in an amount equal to the amount of the rent reserved in this lease for the residue of the term hereof, less the fair rental value of the premises for the residue of said term." The lessee having become bankrupt, the lessor filed its proof of claim under this clause, which the referee expunged as invalid on its face. The judge affirmed the order and the lessor appealed to this court. Meanwhile the Supreme Court on February 5, 1934, affirmed our decision in Manhattan Properties v. Irving Trust Co., and has thus

finally settled it that claims for future rent are not ordinarily provable, and can become so, if at all, only by virtue of special clauses. The question here is whether this clause will serve; its possible validity was specifically reserved in the Supreme Court's opinion.

The contingencies which make such claims unprovable go both to the right of action and to the amount. If the lease contains no covenant of the lessee to pay the equivalent of rent in case of reëntry, any future claim is contingent; it can only be for rent, and the lessor may have reëntered and ended the term before it falls due. Such leases are now rare; ordinarily there is some covenant designed to protect the lessor in case of reëntry. A common form, which was that in In Re Roth & Appel, 181 Fed. Rep. 667 (C. C. A. 2), is to pay on each rent day the difference between the rent reserved and rent received upon any reletting; another is to indemnify the lessor for any loss suffered during the term. The second requires the lessor to wait till the end of the term (Hermitage Co. v. [fol. 54] Levine, 248 N. Y. 333); not so the first, under which a separate cause of action arises at the end of each period. But in both kinds it is uncertain at petition filed whether there will be any loss, and that uncertainty is enough to invalidate the claim. The covenant in the lease at bar avoids both these difficulties. It is not contingent in right, because the mere filing of a petition in bankruptcy puts an end to the lease; not at the lessor's option, but unconditionally. It is not contingent in amount, because at petition filed it is at once ascertainable whether there is a loss and what it is. The fact that the amount of that loss is not fixed in advance is immaterial; the standard of appraisal is prescribed; it involves the kind of determination—that is, the present value of real property—with which a bankruptcy court is entirely familiar and which it is competent to make. The argument contra may be stated as follows: If bankruptcy be an anticipatory breach, as it is, then, in a case where the lessee has promised to pay the loss, the promise or the whole series of promises, is repudiated at once. To calculate the damages, as in the case of other anticipatory breaches, the value of the consideration restored—in this case the land—will be presently estimated by the best means accessible. The

result is exactly the measure to which the parties have themselves agreed in the covenant at bar. If the calculation be too contingent for a bankruptcy claim when there is no covenant, why is there not when there is? This argument loses sight of the real objection to allowing the claim when damages have not been liquidated. That is not because the rule for measuring damages is too vague or uncertain to be manageable in bankruptcy; but that, though it is the best approximation available, it is still only a forecast and a forecast in these circumstances will [fol. 55] not do for bankruptcy which is more rigid as to such issues than other proceedings, an action at law, for example. It is the uncertainty in fact of the loss that invalidates the claim; that is not remedied by an approximation which the law will accept in other connections. But when the parties have agreed that the lessee shall pay a sum to be ascertained by an accessible standard, the bankruptcy court is not liquidating a future loss at all; in its place the parties have substituted a promise, which does not look to the future, which is to pay the difference between two amounts presently ascertainable. The only question is whether that promise is lawful, whether it makes a contract, and as to that we have it on the highest authority that it liquidates "the damages upon a footing familiar and fair." Filene's Sons v. Weed, 245 U. S. 597, 602.

That the occasion was in general apt for the liquidation of damages we need not therefore debate; but there is one doubt that does arise; whether the clause is for a penalty because the future payments are not discounted to their present values. If the lessee must pay at once the sum of a series of installments, each consisting of the difference between the rent reserved on successive rent days, and the estimated rent which will have been received on those days, the recovery will surely be more than compensatory. The present value of such an installment, payable twenty years hence, is very much less than its face. Whether this would invalidate the whole clause under Kothe v. Taylor, 280 U. S. 224, we need not say, because we think that the lease should not be read in that way. We disregard the earlier canon by which all provisions fixing damages were construed as penalties in cases of doubt; the decisions of the Supreme Court no longer give countenance to that notion;

[fol. 56] such clauses are construed without bias. U. S. v. Bethlehem Steel Co., 205 U. S. 105, 119; U. S. v. United Engineering Co., 234 U. S. 236, 241; Wise v. U. S., 249 U. S. 361, 365, 366; Hathaway v. U. S., 249 U. S. 460, 464. So approached, the clause seems to us to admit of a construction in accordance with its patent general purpose to give the lessor indemnity and no more. The damages as liquidated consist of the difference between two amounts each stated as single. The minuend is "the amount of the rent reserved", not the sum of the installments of rent; the subtrahend is "the fair rental value of the premises", again a single sum, and this time phrased as though the term was to be valued like a fee. Of course people do not so value terms, at least ordinarily; they appraise them by the periodic rents obtainable. Probably that was all that was intended here also, but it does not follow that the "rental value of the premises" must be taken by adding the full face of all the estimated future installments. Were a lease to be sold nobody would think of valuing it so; he would discount the future payments. The meaning is indeed doubtful, but as we are not bound to view the language with a hostile eye, we shall construe it to save the clause, and we therefore hold that the proper measure of damage is the sum of the discounted series of installments, each made up of the rent reserved, less the fair rental value for that period. We need not therefore decide whether if future installments were payable at their face the clause would be void as a penalty.

Order reversed; claim remanded for liquidation in accordance with the foregoing.

[fol. 56a] [Endorsed:] United States Circuit Court of Appeals, Second Circuit. In Re Outfitters Operating Realty Co., Inc. Perry v. Irving Trust Co. Opinion. L. Hand, C. J.

[fol. 57] UNITED STATES CIRCUIT COURT OF APPEALS, SECOND CIRCUIT

At a stated term of the United States Circuit Court of Appeals, in and for the Second Circuit, held at the court-rooms in the Post Office building in the City of New York,

on the 20th day of February, one thousand nine hundred and thirty-four.

Present: Hon. Learned Hand, Hon. Thomas W. Swan, Hon. Harrie B. Chase, Circuit Judges.

In the Matter of Outfitters Operating Realty Co., Inc., Bankrupt,

A. W. Perry, Inc., Appellant

Appeal from the District Court of the United States for the Southern District of New York

This cause came on to be heard on the transcript of record from the District Court of the United States for the Southern District of New York, and was argued by counsel.

On consideration whereof, it is now hereby ordered, adjudged, and decreed that the order of said District Court be and it hereby is reversed with costs and cause remanded for entry of an order in accordance with the opinion of this court.

It is further ordered that a Mandate issue to the said District Court in accordance with this decree.

Wm. Parkin, Clerk.

[fol. 58] [Endorsed:] United States Circuit Court of Appeals, Second Circuit. In re Outfitters Operating Realty Co. Inc. Order for Mandate. United States Circuit Court of Appeals, Second Circuit. Filed Feb. 20, 1934. William Parkin, Clerk.

[fol. 59] United States of America,
Southern District of New York:

I, William Parkin, Clerk of the United States Circuit Court of Appeals for the Second Circuit, do hereby certify that the foregoing pages, numbered from 1 to 58, inclusive, contain a true and complete transcript of the record and proceedings had in said Court, in the case of In the Matter of Outfitters Operating Realty Co. Inc., Bankrupt; A. W. Perry, Inc., Appellant, as the same remain of record and on file in my office.

In testimony whereof, I have caused the seal of the said Court to be hereunto affixed, at the City of New York, in the Southern District of New York, in the Second Circuit, this 10th day of April, in the year of our Lord one thousand nine hundred and thirty-four, and of the Independence of the said United States the one hundred and fifty-eighth.

Wm. Parkin, Clerk. (Seal United States Circuit Court of Appeals, Second Circuit.)

(4852-C)

[fol. 60] SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed May 14, 1934

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Second Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Endorsed on cover: File No. 38,572. U. S. Circuit Court of Appeals, Second Circuit. Term No. 22. Irving Trust Company, as Trustee in Bankruptcy of Outfitters Operating Realty Co., Inc., petitioner, vs. A. W. Perry, Inc. Petition for a writ of certiorari and exhibit thereto. Filed April 18, 1934. File No. 22, O. T. 1934.

(5067-C)

23

[redacted]

[redacted]

[redacted] COMPANY, as trustee in Bankruptcy of [redacted] Realty Co., Inc., a Delaware corporation,

Petitioner,

—against—

A. W. PERRY, INC., a Massachusetts corporation,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF.

[redacted]

CHARLES K. BIRKMAN,
EDWARD K. HATTON,
Counsel for Petitioner.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1933.

IRVING TRUST COMPANY, as Trustee in Bankruptcy of Outfitters Operating Realty Co., Inc., a Delaware corporation,

Petitioner,

—against—

A. W. PERRY, INC., a Massachusetts corporation,

Respondent.

Petition for Writ of Certiorari.

To the Honorables, The Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

Your petitioner respectfully submits its petition for a writ of certiorari to review the decision of the Circuit Court of Appeals for the Second Circuit in the above case.

Summary Statement of the Matter Involved.

In 1929 the respondent, A. W. Perry, Inc., leased to the bankrupt corporation, Outfitters Operating Realty Co., Inc., certain premises at No. 459 Washington Street, Boston, Massachusetts, for a term ending December 31, 1945, at a rental starting at the rate of $35,000 per annum for the first ten (10) months, and progressing to the rate of $39,805.00 per annum for the latter years of the demise, plus certain other charges therein specified (R. 11-12).

The lease contained the following provision (R. 16-17):

> "* * * and, for the more effectual securing to the Lessor of the rent and other payments herein provided, it is agreed as a further condition of this lease that the filing of any petition in bankruptcy or insolvency by or against the Lessee shall be deemed to constitute a breach of this lease, and thereupon, *ipso facto* and without entry or other action by the Lessor, this lease shall become and be terminated; and, notwithstanding any other provisions of this lease, the Lessor shall forthwith upon such termination be entitled to recover damages for such breach in an amount equal to the amount of the rent reserved in this lease for the residue of the term hereof less the fair rental value of the premises for the residue of said term."

The bankrupt filed a voluntary petition in bankruptcy in the United States District Court for the Southern District of New York on September 30, 1932, and was adjudicated a bankrupt on that date (R. 1).

The respondent filed a claim in the bankruptcy proceeding for $177,788.00, claiming that amount to be its so-called damages to which it was entitled under the provision of the lease above set forth, although the proof of claim affords no explanation of the computation (R. 8).

The claim was expunged by Referee Kurtz (R. 23-36, 37-38), whose order was affirmed by the District Court (Goddard, *J.*) (R. 43, 44-45).

The orders of the Referee and of the District Court were, however, reversed by the Circuit Court of Appeals with an opinion by L. Hand, *J.* (R. 52-55) in which it was said that the decision of this Court in *Manhattan Properties, Inc.* v. *Irving Trust Company,* 54 S. Ct. Rep. 385, finally determined that claims for future rent are ordinarily not provable "and can become so, if at all, only by virtue of

special clauses"; that the question in this case presented was whether the instant clause would serve; that the possible validity of the instant clause "was specifically reserved" in this Court's opinion in the *Manhattan Properties* case; that while the rule of damages specified in said clause, in the absence of a specific covenant by the parties therefor, would not be acceptable in bankruptcy, the express promise of the lessee in the lease to pay such damages is lawful and gives rise to a provable claim; but that, to avoid the possibility of the promise here made constituting a penalty, it was to be interpreted as providing for the discounting of the minuend, *i. e.*, the rent reserved for the residue of the term. The Circuit Court of Appeals thereupon held that the claim was provable, interpreting the lease as providing for "the sum of the discounted series of instalments, each made up of the rent reserved, less the fair rental value for that period."

Questions Presented.

A.—Can a landlord and tenant turn an otherwise non-provable claim into a provable claim merely by stipulating that, in the event of the bankruptcy of the tenant, the lease shall *ipso facto* terminate and the tenant thereupon be liable to pay liquidated damages?

B.—Assuming that such a stipulation may give rise to a provable claim, is a promise by the lessee to pay as such liquidated damages an amount equal to the rent reserved in the lease for the residue of the term, less the fair rental value of the premises for the residue of the term, nevertheless unenforceable as a penalty and for uncertainty.

Reasons Relied on for Allowance of the Writ.

1. The first question here presented is fundamental and has never been expressly decided by this Court.

In *Manhattan Properties, Inc.* v. *Irving Trust Co., supra,* this Court determined (a) that claims for future rent as such are not provable in bankruptcy; and (b) that covenants of indemnification of the landlord, dependent upon re-entry by the landlord subsequent to the filing of the petition in bankruptcy, do not give rise to provable claims in bankruptcy inasmuch as the landlord must initiate a new contract of indemnity by the affirmative step of re-entry necessarily occurring subsequent to the filing of the petition.

While the *Manhattan Properties* decision disposed of the uncertainty theretofore existing with respect to claims for future rent and indemnity provisions effective after the date of petition filed, there remains undetermined, as a matter of explicit decision, the question as to whether a landlord may nevertheless *create* a provable claim by the device of an express agreement for damages effective by virtue of a termination of the lease automatically resulting from the filing of the petition in bankruptcy.

2. The court below, against the trend of this Court's decisions, has sanctioned this device.

In doing so it has disregarded the following language in the *Manhattan Properties* decision (pp. 387, 388):

> "The courts uniformly held (under the Act of 1867) that claims for future rent or *for damages for breach of covenant to pay rent* were not provable under the act, though differing as to the reason; some holding them not contingent claims within the statutory definition, and others thinking the ex-

> press permission of proof for rent past due at the date of bankruptcy impliedly excluded claims for rent thereafter falling due. * * * In view of the extended consideration and discussion which preceded the passage of the Act (of 1898), the failure to include a provision for claims for loss of rent or *for damages consequent on the abrogation of leases,* is significant of an intent not to depart from the precedents disallowing them." (Italics and parenthetical references ours.)

The court below reached its result by an attempted distinction between the situations arising upon leases containing no covenant for damages, and where, as here, such a covenant is expressed. Even though the measure of damages to be applied might be the same, the court below conceived it as merely a forecast in the former situation, adding that "a forecast in these circumstances will not do for bankruptcy, which is more rigid as to such issues than other proceedings, an action at law, for example." In the latter instance, *i. e.,* where there is an express covenant, the opinion below characterizes it as a promise "which does not look to the future, which is to pay the difference between two amounts presently ascertainable" (R. 54).

The attempted distinction means nothing except that a non-provable claim may be turned into a provable one simply by the *making of the promise.*

To be sure, in *William Filene's Sons Co.* v. *Weed,* 245 U. S. 597, 602, an express covenant for damages was approved because there was a promise, and in *Gardiner* v. *Butler & Co.,* 245 U. S. 603, disapproved because there was no promise.

Both of the cases mentioned, however, arose in *equity,* thus presenting an all important distinction between the situation there at bar and the instant controversy. The

distinction is not ours, but was made by this Court itself in the *Weed* case, when it said (pp. 601-602):

> "When a statutory system is administered the only question for the courts is what the statutes prescribe. But when the courts *without statute* take possession of all the assets of a corporation under a bill like the present and so make it impossible to collect debts except from the court's hands, they have no warrant for excluding creditors, or for introducing supposed equities other than those *determined by the contracts that the debtor was content to make and the creditors to accept.*" (Italics ours.)

The absence or the presence of the promise was material only because the proceeding was in equity.

Two years prior to the *Weed* case this Court, in *Central Trust Co.* v. *Chicago Auditorium Association,* 240 U. S. 581, which arose in a bankruptcy proceeding, held provable a claim for similar damages with respect to a contract for the baggage and livery privilege of the Auditorium Hotel in Chicago, which contained no covenant for liquidation of damages. This Court held that the bankruptcy constituted an anticipatory breach, but pointed out that the situation was to be distinguished from cases arising out of the relation of landlord and tenant, "because of the 'diversity betweene duties which touch the realty and the meere personalty' ", a distinction again made in *Maynard* v. *Elliott,* 283 U. S. 273, at 278.

These cases clearly indicate the trend of this Court's decisions. In bankruptcy it has recognized that damage claims arising from the relationship between landlord and tenant stand apart. In equity only has it rendered effective express covenants in leases to pay such damages, because there the courts, taking possession of the defendant's assets without statute, have no warrant to do otherwise.

3. The decision below has therefore created an exception which points the way to evasion of the long established rule.

If landlords, who may not prove for rent, may still prove for damages for its loss by mere recourse to express covenants, leases to corporate tenants will be written with the instant clause substantially incorporated. Landlords will be insistent, particularly in the case of long term leases at high rentals. Corporate tenants will be acquiescent, in the realization that not they but their bankrupt estates will bear the burden of the promise (See *Kothe* v. *R. C. Taylor Trust,* 280 U. S. 224, 226).

Whether or not such an exception is to be engrafted upon the rule will not be definitely known until this Court has spoken. No certainty can be achieved short of its decision, and yet such certainty is of the utmost importance. The question is of course of substance in the instant case because of the length of the term and the amount of the rent reserved. It is of infinitely greater importance to the business world at large as a guide to the future.

If the decision below is correct, banks, manufacturers, merchants and others extending credit will be forced to take into consideration, particularly in the case of long term leases, the probability of having to compete with claims of overwhelming size. If it is not correct this credit menace should be speedily eliminated by finally authoritative decision.

4. Moreover, there is conflict with applicable decisions of this Court in another material aspect, for the express promise here contained sounds as a *penalty* rather than as a promise to pay liquidated damages.

The court below was sensible of this difficulty, for it said (R. 54):

"* * * but there is one doubt that does arise:

> whether the clause is for a penalty because the future payments are not discounted to their present values. If the lessee must pay at once the sum of a series of instalments, each consisting of the difference between the rent reserved on successive rent days, and the estimated rent which will have been received on those days, the recovery will surely be more than compensatory. The present value of such an instalment, payable twenty years hence, is very much less than its face."

The opinion then refers to this Court's decision in *Kothe* v. *R. C. Taylor Trust, supra,* in which a clause verbatim with that at bar (save for the subtrahend) was condemned as an unenforcible penalty, whose real design "was to insure to the lessor preferential treatment in the event of bankruptcy."*

The *Kothe* case dealt with a lease, which had but fifteen months to run, and yet the provision for damages in the amount of the rent for those fifteen months was held to be "disproportionate to any damage reasonably to be anticipated in the circumstances disclosed."** Here the lease at the time of bankruptcy had upwards of twelve years to run.

The decision below sought to avoid the result in the *Kothe* case by interpreting into the language of the instant clause a discount provision, the lease being thus allegedly construed in accordance with what the court below conceived to be "its patent general purpose to give the lessor indemnity, and no more" (R. 55).

This Court did not attempt such a construction in the Kothe case, but condemned the clause as it was written. Nevertheless the court below supplemented the language of the lease at bar so as to hold that the proper measure of damages under the terms was "the sum of the *discounted*

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* 280 U. S., at 227.
** 280 U. S., at 226.

series of instalments, each made up of the rent reserved, less the fair rental value for that period" (R. 55).

In *Hermitage Co.* v. *Levine,* 248 N. Y. 333, Mr. Justice (then Chief Judge) Cardozo said of the damage clause there involved:

> "If the damage clause as drawn gives inadequate protection, the fault is with the draftsman. The courts are not at liberty to supply its omissions at the expense of a tenant whose liability for the future ended with the cancellation of the lease, except insofar as he bound himself by covenant to liability thereafter."

That language is applicable with even more force here, where the liability is that of the bankrupt's estate rather than of the tenant, and where there are to be considered the interests of creditors rather than those of the tenant who made the promise.

5. In *William Filene's Sons Co.* v. *Weed, supra,* the subtrahend of the formula was the "rental value at the date of entry," a figure reasonably susceptible of determination because predicated upon a date approximately at hand. Such is not the subtrahend provided in the clause at bar, where there is to be subtracted from the discounted instalments of rent reserved "the fair rental value of the premises for the residue of said term."

This must mean that the rental value is to be determined as of the due date of each of the several instalments of rent. Month by month in the years the lease has to run, the rental value must be sought for. Conjecture and speculation must be given fullest rein.

Moreover, in determining the fair rental there must be taken into consideration that under the lease itself there may be no rental value in certain contingencies.

The lease itself expressly provides (R., pp. 15, 11) that in the event of fire which destroys the entire premises so that the lessor's over-lease is cancelled, or in the event of the destruction of the whole or any part of the building by any other unavoidable casualty, or in the event that the premises are taken by public authority for public purpose, the lessor may terminate the lease; but in any event upon the happening of any such contingency the rent is to be suspended or abated until the premises are rehabilitated. These contingencies affect vitally the question not only of the amount, but of the very existence of any damage to the landlord, and yet, whether or not any of them may happen during the twelve year balance of the term, it is impossible to forecast. (Compare *Dunbar* v. *Dunbar,* 190 U. S. 340, 345.)

Such a subtrahend would appear to fall precisely within the condemnation of this Court in *Maynard* v. *Elliott, supra,* when it said at page 278:

> "Or, the contingency may be such as to make any valuation of the claim impossible even though liability has attached."

Therefore again is presented a result in conflict with an applicable decision of this Court.

6. This case presents both principal problems that may arise in respect of an *ipso facto,* self-executing clause for damages in a real estate lease, *i. e.,* whether it is a permissible device to give rise to a provable claim, and, if so, what circumscription should be written to avoid the faults of penalty, conjecture and uncertainty.

We believe that we are not unjustified in saying that, in the absence of the disposition of the matter by this Court, the problems here raised will continue to plague the business world with increasing pressure, because of the weight which the decision below will necessarily carry. However, the problem is even now a pressing one, as the instant case

is not a solitary example of the type of clause here at bar. We are informed that in the bankruptcy proceedings of the Louis K. Liggett Company there are pending four similar cases in the United States District Court for the Southern District of New York and in the Circuit Court of Appeals for the Second Circuit, in which are involved claims aggregating $399,765.34, upon which it is anticipated dividends will be payable, if the claims are not expunged, in an amount in excess of $200,000.

By exercising jurisdiction in this case, the Court presumably will be able to dispose of the entire subject. To do so will be to supply certainty where uncertainty has arisen, facilitate the expeditious disposition of bankruptcies now pending, and guide the business world, bench and bar for the future.

WHEREFORE, your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the United States Circuit Court of Appeals for the Second Circuit, commanding that court to certify to and send to this Court for its review and determination, on a day certain to be therein named, a full and complete transcript of the record and all proceedings in the case numbered and entitled on its docket No. 201, in re Outfitters Operating Realty Co., Inc. (a Delaware corporation), Bankrupt, A. W. Perry, Inc., Appellant, against Irving Trust Company, Trustee, Appellee, and that the said decree of the said Circuit Court of Appeals for the Second Circuit may be reversed by this Honorable Court, and that your petitioner may have such other and further relief in the premises as to this Honorable Court may seem meet and just; and your petitioner will ever pray.

IRVING TRUST COMPANY, as Trustee in Bankruptcy of Outfitters Operating Realty Co., Inc., a Delaware corporation,

Petitioner,

By CHARLES K. BEEKMAN,
EDWARD K. HANLON,
Counsel for Petitioner.

IN THE

Supreme Court of the United States

OCTOBER TERM, 1933.

IRVING TRUST COMPANY, as Trustee in Bankruptcy of Outfitters Operating Realty Co., Inc., a Delaware corporation,

Petitioner,

—against—

A. W. PERRY, INC., a Massachusetts corporation,

Respondent.

BRIEF IN SUPPORT OF PETITION.

Opinions Below.

The opinion of the Referee (R. 23-36) is not reported in the Federal Reporter or Supplement.

The opinion of the District Court (per Goddard, *J.*) (R. 43) is not reported in the Federal Reporter or Supplement.

The opinion of the Circuit Court of Appeals (R. 52-55) is reported at 69 F (2d) 90.

Jurisdiction.

The decree of the Circuit Court of Appeals for the Second Circuit, sought to be reviewed, was entered on February 20th, 1934 (R. 55-56).

The jurisdiction of this Court is invoked under Section 240-a of the Judicial Code, as amended by the Act of February 13, 1925 (U. S. C., Title 28, §347(a)).

Statement of Facts.

The facts have been stated in the petition.

Specification of Errors.

It is submitted that the court below erred:

(1) In reversing the decree of the District Court.

(2) In holding that the proof of claim of the respondent set forth a provable claim, and that it should be liquidated and allowed.

(3) In holding that a provision in a lease for real property, to the effect that in the event of the filing of a petition in bankruptcy by or against the lessee the lease should *ipso facto* terminate, and the lessee thereupon become liable to pay to the lessor damages in an amount equal to the amount of the rent reserved in the lease for the residue of the term, less the fair rental value of the premises for the residue of said term, gave rise to a provable claim in bankruptcy.

(4) In holding that such provision gave rise to a provable claim in bankruptcy notwithstanding the decision of this Court in *Manhattan Properties, Inc.* v. *Irving Trust Company,* 54 Sup. Ct. Rep. 385, inasmuch as it is for damages for breach of a covenant to pay rent.

(5) In holding that such provision gave rise to a provable claim in bankruptcy notwithstanding the decision of this Court in *Kothe* v. *R. C. Taylor Trust,* 280 U. S. 224, inasmuch as the minuend clause of the formula there set forth sounds in penalty.

(6) In holding that such provision gave rise to a provable claim in bankruptcy notwithstanding the decision of this Court in *Maynard* v. *Elliott,* 283 U. S. 273, inasmuch as the subtrahend clause of the formula there set forth is such as to render valuation impossible.

Statute Involved.

Section 63 of the Bankruptcy Act provides:

> "Debts which may be proved. (a) Debts of the bankrupt may be proved and allowed against his estate which are (1) a fixed liability, as evidenced by a judgment or an instrument in writing, absolutely owing at the time of the filing of the petition against him, whether then payable or not, with any interest thereon which would have been recoverable at that date or with a rebate of interest upon such as were not then payable and did not bear interest; * * * (4) founded upon an open account, or upon a contract express or implied; * * *.
>
> "(b) Unliquidated claims against the bankrupt may, pursuant to application to the court, be liquidated in such manner as it shall direct, and may thereafter be proved and allowed against his estate."

Section 1 (11) provides:

> "'debt' shall include any debt, demand or claim provable in bankruptcy";

Section 17 provides:

> "A discharge in bankruptcy shall release a bankrupt from all of his provable debts * * *" with exceptions not here material.

(Act of July 1, 1898, Sections 1, 17 and 63, 30 Stat. 562, as amended; U. S. C., Title 11, Sections 1, 35 and 103.)

Summary of Argument.

I.

The long established rule that claims for rent and for damages for breach of rent covenants are not provable in bankruptcy, is not to be avoided by mere resort to an express agreement in the lease to pay liquidated damages upon a stipulated *ipso facto* termination of the lease on the filing of a petition in bankruptcy by or against the tenant.

(A) The rationale of the opinion below is based upon the solitary circumstance of an express agreement to pay such damages.

(B) An exception to the general rule based upon such a consideration finds no justification in the trend of judicial decision, but is in fact contrary to it.

(C) Nor is there any logical reason why the inclusion of an express covenant should create an exception to the general rule.

II.

Even assuming that a landlord and tenant may turn an otherwise non-provable claim into a provable claim by the device of stipulating that, in the event of the filing of a petition in bankruptcy by or against the tenant, the lease shall *ipso facto* terminate and the tenant thereupon be liable to pay liquidated damages, the instant clause would not in any event give rise to a provable claim because

(A) The minuend clause sounds in penalty rather than liquidated damages; and

(B) The subtrahend clause renders valuation impossible, since (a) it involves a month to month inquiry for the balance of the term as to the rental

value on each of the stipulated rental dates, and (b) impossibility of valuation also ensues because of the provisions of the lease with respect to the termination and abatement of rent in certain contingencies.

Argument.

I.

The long established rule that claims for rent or damages for breach of rent covenants are not provable in bankruptcy is not to be avoided by mere resort to express agreement to pay liquidated damages upon a stipulated *ipso facto* termination of the lease on the filing of a petition in bankruptcy by or against the tenant.

Pointing out that under the Act of 1867 the courts uniformly held that "claims for future rent or for *damages for breach of covenants to pay rent* were *not provable*",* and that, in view of the extended consideration and discussion which preceded the passage of the Act of 1898, "the failure to include a provision for claims for loss of rent or for *damages consequent on the abrogation of leases* is significant of an intent *not* to depart from the precedents disallowing them", this Court said in *Manhattan Properties, Inc.* v. *Irving Trust Co.*, 54 Sup. Ct. Rep. 385, 388:

> "In this situation 'only compelling language in the statute itself would warrant the rejection of a construction so long and so generally accepted'."

We may therefore properly conclude that by the *Manhattan Properties* decision this Court intended to determine that claims for loss of rent and claims for damages for

* Italics by counsel unless otherwise stated.

breach of covenants to pay rent are not provable under the Act.

Yet although this Court's decision in the *Manhattan Properties* case contained no expression of belief that the rule permitted of exception, in the instant case the court below has held that damages for breach of a covenant to pay rent *are* provable where the lessee has expressly agreed to pay them upon a stipulated *ipso facto* termination of the lease on the filing of a petition in bankruptcy by or against the tenant.

In the opinion below the court remarks (R. 53) that the instant situation was "specifically reserved" by this Court in the *Manhattan Properties* decision. This misapprehension was due to the failure to observe that the reference in the *Manhattan Properties* decision (at p. 389) to the instant situation was solely in response to a contention raised by the petitioners in that case, and not intended to be expressive of an exception.

That the court below is still in grave doubt as to the correctness of the result in the instant case, is apparent from the following comment in its opinion in *Wright* v. *Irving Trust Company* (not yet reported), a case decided subsequently to that at bar, where the same judge who wrote the opinion below said, in speaking of the *Manhattan Properties* decision:

> "As we understand it, the invalidity of rent claims is not deduced from the statute, but is a historical exception; the earlier acts by judicial construction had refused to allow claims for future rents, even when contingent claims were provable; although such claims are now generally provable, not only did Congress fail to include rents in 1898, but it continued inert through many amendments, in spite of a number of decisions in accord with the earlier interpretation. *It is not altogether plain how we ought*

> *to circumscribe such a doctrine; how far it should be limited to the occasions which have heretofore arisen; how far we should rationalize it in the interest of convenience in application."*

It might be fairly said that there is nothing in the decisions of this Court which justifies the suggestion that the doctrine with respect to rent claims ought to be circumscribed in any fashion.

Yet here the circumscription sought to be effected arises, not from any variation in the subject matter, but by reason merely of an express agreement between the parties. If such a principle is to be established there appears no reason why the corollary should not also be true, *i. e.*, that parties may stipulate as to what claims will *not* be provable in bankruptcy, and therefore not dischargeable.

A.—*The Rationale of the Opinion Below Is Based Upon the Solitary Circumstance of an Express Agreement to Pay Damages.*

The court below recognized that the measure of damages provided for in this lease would be unacceptable in the absence of an express covenant therefor, since it would be "only a forecast, and a forecast in these circumstances will not do for bankruptcy, which is more rigid as to such issues than other proceedings, an action at law for example". The court then said (R. 54):

> "But when the parties have agreed that the lessee shall pay a sum to be ascertained by an accessible standard, the bankruptcy court is not liquidating a future loss at all; in its place the parties have substituted a promise, which does not look to the future, which is to pay the difference between two amounts presently ascertainable. *The only question is whether that promise is lawful,* whether it makes a contract, and as to that we have it on the highest authority

> that it liquidates 'the damages upon a footing familiar and fair'. *Filene's Sons* v. *Weed*, 245 U. S. 597, 602."

In other words, the measure of damages here provided only became acceptable to the court below by virtue of its definite expression in the lease.

B.—*Such an Exception Finds No Justification in the Trend of Judicial Decision, but Is in Fact Contrary to It.*

Certainly such a novel doctrine finds no warrant in the statute, and the court below cites no judicial authority in its support.

This Court has not expressly passed upon the question. Two lower Federal courts have.

That an express covenant will not create an exception in a rent case was the holding in *Matter of Bliss Auto Sales Company*, 224 A. B. R., N. S., 44 (not officially reported; D. C., N. D. of Ohio, W. D.). Such was also the result in *Wells* v. *Twenty-First Street Realty Co.*, 12 F. (2d) 237 (C. C. A., 6th Circ.), as appears from the provisions of the lease there at bar, which are to be found in the report of that case in the District Court, *sub nom. In re Bissinger & Co.*, 5 F. (2d) 106.

We assume that, strictly speaking, the *Manhattan Properties* decision must be confined to the precise problem there before the Court, which had to do with claims for future rent and indemnification clauses effective only after petition filed. The philosophy of that decision, however, is clearly applicable to the general trend of judicial thought, which has been condemnatory of all claims for damages arising out of rent clauses.

The rule has not been confined, either in its direct expression or by implication, solely to cases of claims for future rent as such, but has embraced generally claims for *damages* arising out of covenants for the payment of rent.

Manhattan Properties, Inc. v. *Irving Trust Co., supra,* at 387, 388.

See also *Wells* v. *Twenty-First Street Realty Co., supra,* at page 238, where it was said:

> "The law seems to be well settled that, in states where the common law obtains, *a claim for damages for an anticipatory breach of a lease for real estate is not provable in bankruptcy.*"

Coordination of this doctrine to cases affecting personalty is futile, since the distinction is historical. As this Court said in *Gardiner* v. *Butler & Co.,* 245 U. S. 603, 605:

> "But the law as to leases is not a matter of logic *in vacuo;* it is a matter of history that has not forgotten Lord Coke."

There are four decisions of this Court strongly indicative of its opinion that claims for damages are as unacceptable as claims for future rent themselves.

In *Gardiner* v. *Butler & Co., supra,* an equity proceeding, this Court denied a claim for damages upon a basis somewhat similar to that at bar. (There the lease did not contain any clause providing for such damages.)

In *Wm. Filene's Sons & Co.* v. *Weed,* 245 U. S. 597, arising in the same equity receivership as the *Gardiner* case and the opinion being written by the same eminent jurist, there was an express covenant for the payment of damages, to wit, the difference between the rental value at the date of entry and the rent reserved. The claim was allowed, but the Court expressly pointed out (pp. 601, 602) that the case was to be distinguished from a bankruptcy proceeding, for the reason that, having taken possession of all of the assets of the corporation, not under

a statute but under a bill in equity, the courts "have no warrant for excluding creditors, or for introducing supposed equities other than those determined by the contracts that the debtor was content to make and the creditors to accept".

The conclusion is inescapable that a like result would not have been achieved in bankruptcy. Yet there was there an express covenant for the payment of such damages.

In *Central Trust Co.* v. *Chicago Auditorium Association*, 240 U. S. 581, a claim was held provable for similar damages with respect to a contract for the baggage and livery privilege of the Auditorium Hotel in Chicago. There the contract contained no express covenant for liquidation of damages. The Court, however, was careful to distinguish between that case and a case "arising out of the relation of landlord and tenant" (pp. 589-590).

Again, in *Maynard* v. *Elliott*, 283 U. S. 273, the Court sanctioned a claim against the bankrupt as an endorser upon certain notes not yet matured or dishonored, but again adverted to the fact that some contingent claims are deemed not provable, and cited as an example *Atkins* v. *Wilcox*, 105 Fed. 595, a claim for future rent.

These four decisions of this Court are all mutually consistent and may be rationalized as follows:

In equity proceedings the courts, not dealing with a statutory system but acting purely by virtue of their inherent chancery powers, must give effect to contracts as written by the parties.

In bankruptcy the court is dealing with a statutory system and can allow only such claims as the statute permits.

As a matter of historical distinction, sanctioned by

long legislative history, the statute generally permits proofs of claim for anticipatory breaches of contracts, but in respect of the relationship of landlord and tenant claims for rent and for damages for breach of covenants to pay rent are not provable.

In equity there may be a distinction between the making and the absence of a promise; in bankruptcy the distinction has to do with the *subject matter.*

For the sake of completeness, one word should be said with respect to the decision of this Court in *Kothe* v. *R. C. Taylor Trust,* 280 U. S. 224. In that case there was presented to the Court in a bankruptcy case a provision in a lease exactly like that at bar, with the exception that there was no subtrahend clause. The Court rejected the claim, treating the covenant as creating a penalty. That it did not advert to its provability generally as a matter of bankruptcy law can create no inference one way or another. That decision preceded the *Manhattan Properties* case, and there was no reason why the Court should then discuss the larger question of the provability of rent claims, which it had then not yet decided, in view of the simple fact that under no consideration could the claim there presented be allowed.

C.—*Nor Is There Any Logical Reason Why the Inclusion of an Express Covenant Should Create an Exception to the General Rule.*

Prior to the *Manhattan Properties* case a frequently ascribed reason for the principle denying the provability of rent claims was their contingency. *Atkins* v. *Wilcox,* 105 Fed. 595; *In re Roth & Appell,* 181 Fed. 667; and see *Maynard* v. *Elliott, supra,* at page 278.

The *Manhattan Properties* decision rests the doctrine upon historical grounds, the view thereafter taken by the court below in *Wright* v. *Irving Trust Company, supra.*

The fundamental basis, therefore, is an historical distinction between claims affecting landlord and tenant and those affecting other relationships. Under such circumstances there is no reasonable justification, nor can any possible basis be found in the historical sanction for the rule, for disregarding the peculiarities of the landlord and tenant relationship simply because recourse has been had to an express covenant. Adhesion to such a distinction would be so startling as to be justified only by the most cogent reasoning and statutory and judicial warrant. All are lacking.

II.

All other considerations apart, the instant clause would not in any event give rise to a provable claim.

We now assume, for the purposes of the instant discussion, that a landlord and tenant may turn an otherwise non-provable claim into a provable claim by the device of stipulating that, in the event of the bankruptcy of the bankrupt, the lease shall *ipso facto* terminate, and the tenant thereupon be liable to pay liquidated damages.

Even so postulated, the formula at bar is unacceptable as a basis for a provable claim in bankruptcy.

A. *The Minuend Clause Sounds in Penalty Rather than Liquidated Damages.*

In *Kothe* v. *R. C. Taylor Trust, supra,* this Court condemned a clause written (save for the absence of the subtrahend clause) in precisely the language of the clause here at bar. The clause there before the Court read (p. 225):

> "The filing of any petition in bankruptcy * * * by or against the Lessee shall be deemed to constitute a breach of this lease, and thereupon, *ipso facto*

and without entry or other action by the Lessor, this lease shall become and be terminated; and, notwithstanding any other provisions of this lease the Lessor shall forthwith upon such termination be entitled to recover damages for such breach in an amount equal to the amount of the rent reserved in this lease for the residue of the term hereof."

The Court said of that clause (pp. 226-227):

"The amount thus stipulated is so disproportionate to any damage reasonably to be anticipated in the circumstances disclosed that we must hold the provision is for an unenforceable penalty. The parties were consciously undertaking to contract for payment to be made out of the assets of a bankrupt estate—not for something which the lessee personally would be required to discharge. He, therefore, had little, if any, immediate concern with the amount of the claim to be presented; most probably, that would affect only those entitled to share in the proceeds of property beyond his control.

The broad purpose of the Bankruptcy Act is to bring about an equitable distribution of the bankrupt's estate among creditors holding just demands based upon adequate consideration. Any agreement which tends to defeat that beneficent design must be regarded with disfavor. Considering the time which the lease here involved had to run, nothing else appearing, it seems plain enough that the real design of the challenged provision was to insure to the lessor preferential treatment in the event of bankruptcy."

The court below was cognizant of this difficulty, for it said (R. 54):

"* * * but there is one doubt that does arise; whether the clause is for a penalty because the future payments are not discounted to their present values.

> If the lessee must pay at once the sum of a series of installments, each consisting of the difference between the rent reserved on successive rent days, and the estimated rent which will have been received on those days, *the recovery will surely be more than compensatory.* The present value of such an installment, payable twenty years hence, is very much less than its face."

The situation here is a more aggravated one than that before the court in the *Kothe* case, for here the lease had twelve years to run as against but fifteen months there. "Considering the time which the lease here involved had to run" (to use the words of the *Kothe* case), a minuend of *all* the rent reserved for the lengthy balance of the term constitutes even more clearly an amount "so disproportionate to any damage reasonably to be anticipated in the circumstances disclosed", that it should be held, as in that case, an unenforceable penalty.

It should also be borne in mind that the circumstance which gave rise to a so-called breach of the lease, and which involved this drastic formula for damages, bears no necessary reference to fault on the part of the tenant. An involuntary bankruptcy proceeding might be filed against the tenant and subsequently dismissed for lack of merit. The lease will, nevertheless, have come to an end, and the tenant be required to bear the burden of the formula.

To avoid the condemned result of penalty, the court below read into the minuend clause of the instant formula a provision for *discounting* the future rent reserved. Such an interpretation or construction of the language of the lease was not even attempted by this Court in the *Kothe* case. Yet the court below ventured to do so "to save the clause" (R. 55), a result which it is submitted the court was not free to reach, for, as Mr. Justice (then Chief

Judge) Cardozo said in *Hermitage* v. *Levine,* 248 N. Y. 333, 338:

> "If the damage clause as drawn is inadequate protection, the fault is with the draftsman. The courts are not at liberty to supply its omissions at the expense of a tenant whose liability for the future ended with the cancellation of the lease except in so far as he bound himself by covenant to liability thereafter."

B.—*The Subtrahend Clause Renders Valuation Impossible.*

In *Maynard* v. *Elliott, supra,* at page 278, the Court pointed out that not all contingent claims are provable, saying:

> "Or, the contingency may be such as to make any valuation of the claim impossible, *even though liability has attached.*"

The clause at bar provides that damages be computed in an amount "equal to the amount of the rent reserved in this lease for the residue of the term hereof *less the fair* [illegible] *for the residue of said term*".

1. *This involves a month by month inquiry for the balance of the term.*

If this subtrahend clause is to be interpreted as referring to the fair rental value as of the due date of each of the several instalments of rent, as would seem to be its meaning, the court will be projected into an inquiry which can only be resolved by the sheerest conjecture and speculation. The lease has twelve years to run. The rental is payable monthly (R. 12). Therefore, in computing the subtrahend of the formula it will be necessary to make inquiry as to value for each of the monthly rent days for the twelve years to come.

The difficulties of such an inquiry were well stated by the court below itself in its decision in *In re Metropolitan Stores, Inc.*, 66 F. (2d) 482, at page 484, where it was dealing with a claim for an anticipatory breach of a lease whose term had not begun at the date of petition filed. The court said (p. 484) that presumably the measure of damages would be "the difference between the rent stipulated in the lease and rent obtainable from other parties if the premises are re-let" (*i. e.*, the rental value). The court continued:

> "In the case at bar the original term was not to begin until January 1, 1935, and was to run for thirty years thereafter. Whether during that distinct period the landlord will profit or lose by reason of the prospective tenant's repudiation of his contract (assuming without decision that bankruptcy may be deemed such) *is pure speculation.*"

The application of such a formula readily seemed speculative to the court below where projected over thirty years. At bar it is only less so as a matter of degree. Valuation is impossible in either case, and hence in bankruptcy inacceptable.

2. *Impossibility of valuation also ensues because of the lease provisions for termination and abatement of rent.*

The fair rental value in the future cannot be estimated without also taking into consideration certain provisions of the lease under which there may be no rent to pay.

The lease provides (R. 15):

> "THIS LEASE IS MADE ON CONDITION that, in case the premises, or the estate of which they may form part, be in whole or part destroyed or damaged by fire, or other unavoidable casualty, or if said estate

be in whole or part taken by public authority for any public purpose, this lease may, at the election of the Lessor, be terminated; provided, that, if the same be not so terminated, a just and proportionate part of the rent shall be suspended or abated until the premises shall have been put by the Lessor in as good condition as at the date of such damage or taking; and the Lessee hereby assigns to the Lessor any and all claims and demands for damages on account of such taking."

Were we dealing with a provision for liquidated damages upon the basis of value at the date of petition filed, or date of entry (*cf. William Filene's Sons Co.* v. *Weed*, *supra*), this clause would be immaterial. In attempting, however, to estimate the fair rental value of the premises month by month as instalments become payable in the future, it is inevitable that there be taken into consideration the fact that the payment of rent may be suspended or abated under the terms of the lease by the happening of any one of the several eventualities in the paragraph above quoted. Yet to do so is manifestly to make impossible any valuation of the claim.

The situation is much akin to that in *Dunbar* v. *Dunbar*, 190 U. S. 340, where a claimant sought to prove against her bankrupt divorced husband upon an alimony agreement to pay her a stipulated sum "during her life, or until she marries". The Court remarked (p. 345):

"But how can any calculation be made in regard to the continuance of widowhood where there are no tables and no statistics by which to calculate such contingency? How can a valuation of a probable continuance of widowhood be made? Who can say what the probability of remarrying is in regard to any particular widow? We know what some of the factors might be in the question; inclination, age,

> health, property, attractiveness, children. These would at least enter into the question as to the probability of continuance of widowhood, and yet there are no statistics which can be gathered which would tend in the slightest degree to aid in the solving of the question."

Like methods of calculation here are wanting as to destruction, or damage by fire or other unavoidable casualty, or condemnation by public authority, so that any basic certitude upon which could be predicated computation cannot be resorted to.

C.—*Whether or Not the Claim Would Otherwise Be Provable, the Minuend Is Clearly Written in Terms of Penalty and the Subtrahend Presents a Method of Valuation Impossible of Pursuit. Either Consideration Renders the Claim Not Provable.*

CONCLUSION.

A writ of certiorari should be granted.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1934.

No. 22.

IRVING TRUST COMPANY, as Trustee in Bankruptcy of Outfitters Operating Realty Co., Inc., a Delaware corporation,

Petitioner,

—against—

A. W. PERRY, INC., a Massachusetts corporation,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF OF PETITIONER.

Opinions Below.

The opinion of the Referee (R. 13-23) is not reported in the Federal Reporter or Supplement.

The opinion of the District Court (per Goddard, *J.*) (R. 26) is not reported in the Federal Reporter or Supplement.

The opinion of the Circuit Court of Appeals (R. 31-34) is reported at 69 F. (2d) 90.

Jurisdiction.

The decision of the Circuit Court of Appeals for the Second Circuit, here to be reviewed, was filed on February 20, 1934 (R. 34, 35).

The jurisdiction of this Court was invoked under Section 240-a of the Judicial Code, as amended by the Act of February 13, 1925 (U. S. C., Title 28, Section 347 (a)).

Certiorari was granted by this Court on May 14, 1934 (R. 37).

Statement of Facts.

The petitioner is the trustee in bankruptcy of Outfitters Operating Realty Co., Inc. (R. 1).

In 1929 the respondent, A. W. Perry, Inc., leased to the bankrupt corporation, Outfitters Operating Realty Co., Inc., certain premises at No. 459 Washington Street, Boston, Massachusetts, for a term ending December 31, 1945, at a rental starting at the rate of $35,000 per annum for the first ten (10) months, and progressing to the rate of $39,805.00 per annum for the latter years of the demise, plus certain other charges therein specified (R. 6-7).

The lease contained the following provision (R. 10):

> "* * * and, for the more effectual securing to the Lessor of the rent and other payments herein provided, it is agreed as a further condition of this lease that the filing of any petition in bankruptcy or insolvency by or against the Lessee shall be deemed to constitute a breach of this lease, and thereupon, *ipso facto* and without entry or other action by the Lessor, this lease shall become and be terminated; and, notwithstanding any other provisions of this lease, the Lessor shall forthwith upon such termination be entitled to recover damages for such breach in an amount equal to the amount of the rent reserved in this lease for the residue of the term hereof less the fair rental value of the premises for the residue of said term."

The bankrupt filed a voluntary petition in bankruptcy in the United States District Court for the Southern District of New York on September 30, 1932, and was adjudicated a bankrupt on that date (R. 1).

The respondent on March 29, 1933 (R. 1) filed a claim in the bankruptcy proceeding for $177,788.00, claiming that amount to be its so-called damages to which it was entitled under the provision of the lease above set forth, although the proof of claim affords no explanation of the computation (R. 4-5).

The claim was expunged by Referee Kurtz (R. 13-23), whose order was affirmed by the District Court (Goddard, *J.*) (R. 26-27).

The orders of the Referee and of the District Court were, however, reversed by the Circuit Court of Appeals with an opinion by L. Hand, *J.* (R. 31-34) in which it was said that the decision of this Court in *Manhattan Properties, Inc.* v. *Irving Trust Company*, 291 U. S. 320, finally determined that claims for future rent are ordinarily not provable "and can become so, if at all, only by virtue of special clauses"; that the question in this case presented was whether the instant clause would serve; that the possible validity of the instant clause "was specifically reserved" in this Court's opinion in the *Manhattan Properties* case; that while the rule of damages specified in said clause, in the absence of a specific covenant by the parties therefor, would not be acceptable in bankruptcy, the express promise of the lessee in the lease to pay such damages is lawful and gives rise to a provable claim; but that, to avoid the possibility of the promise here made constituting a penalty, it was to be interpreted as providing for the discounting of the minuend, *i. e.*, the rent reserved for the residue of the term. The Circuit Court of Appeals thereupon held that the claim was provable, interpreting the lease as providing

for damages in "the sum of the discounted series of installments, each made up of the rent reserved, less the fair rental value for that period."

Questions Presented.

A.—Can a landlord and tenant turn an otherwise non-provable claim into a provable claim merely by stipulating that, in the event of the bankruptcy of the tenant, the lease shall *ipso facto* terminate and the tenant thereupon be liable to pay liquidated damages?

B.—Assuming that such a stipulation may give rise to a provable claim, is a promise by the lessee to pay as such liquidated damages an amount equal to the rent reserved in the lease for the residue of the term, less the fair rental value of the premises for the residue of the term, nevertheless unenforceable as a penalty and for uncertainty?

Specification of Assigned Errors To Be Urged.

All of the assigned errors are intended to be urged, as follows, to wit:

The Circuit Court of Appeals erred:

(1) In reversing the decree of the District Court.

(2) In holding that the proof of claim of the respondent set forth a provable claim, and that it should be liquidated and allowed.

(3) In holding that a provision in a lease for real property, to the effect that in the event of the filing of a petition in bankruptcy by or against the lessee the lease

should *ipso facto* terminate, and the lessee thereupon become liable to pay to the lessor damages in an amount equal to the amount of the rent reserved in the lease for the residue of the term, less the fair rental value of the premises for the residue of said term, gave rise to a provable claim in bankruptcy.

(4) In holding that such provision gave rise to a provable claim in bankruptcy notwithstanding the decision of this Court in *Manhattan Properties, Inc.* v. *Irving Trust Company,* 291 U. S. 320, inasmuch as it is for damages for breach of a covenant to pay rent.

(5) In holding that such provision gave rise to a provable claim in bankruptcy notwithstanding the decision of this Court in *Kothe* v. *R. C. Taylor Trust,* 280 U. S. 224, inasmuch as the minuend clause of the formula there set forth sounds in penalty.

(6) In holding that such provision gave rise to a provable claim in bankruptcy notwithstanding the decision of this Court in *Maynard* v. *Elliott,* 283 U. S. 273, inasmuch as the subtrahend clause of the formula there set forth is such as to render valuation impossible.

Statute Involved.

Section 63 of the Bankruptcy Act provides:

> "Debts which may be proved. (a) Debts of the bankrupt may be proved and allowed against his estate which are (1) a fixed liability, as evidenced by a judgment or an instrument in writing, absolutely owing at the time of the filing of the petition against him, whether then payable or not, with any interest thereon which would have been recoverable at that date or with a rebate of interest upon such

as were not then payable and did not bear interest; * * * (4) founded upon an open account, or upon a contract express or implied; * * * (7) claims for damages respecting executory contracts including future rents whether the bankrupt be an individual or a corporation, but the claim of a landlord for injury resulting from the rejection by the trustee of an unexpired lease of real estate or for damages or indemnity under a covenant contained in such lease shall in no event be allowed in an amount exceeding the rent reserved by the lease, without acceleration, for the year next succeeding the date of the surrender of the premises plus an amount equal to the unpaid rent accrued up to said date: Provided, That the court shall scrutinize the circumstances of an assignment of future rent claims and the amount of the consideration paid for such assignment in determining the amount of damages allowed assignee hereunder: Provided further, That the provisions of this clause (7) shall apply to estates pending at the time of the enactment of this amendatory Act, in which the time for filing such claims has not expired.*

"(b) **Unliquidated claims against the bankrupt may, pursuant to application to the court, be liquidated in such manner as it shall direct, and may thereafter be proved and allowed against his estate."

Section 1 (11) provides:

"'debt' shall include any debt, demand, or claim provable in bankruptcy."

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* Clause (7) was added, subsequent to the granting of the petition herein, by the Act of June 7, 1934, with the exception of the closing words, "in which the time for filing such claims has not expired". These closing words were later added by the Act of June 18, 1934.

** While the Act of June 7, 1934 added a new paragraph (b) to Section 63 to precede the old paragraph "(b)", the amendment did not change the symbol of the old paragraph, with the result that there are now two paragraphs in the Section indicated by the letter "(b)".

Section 17 provides:

> "A discharge in bankruptcy shall release a bankrupt from all of his provable debts * * *"

with exceptions not here material.

Section 57 (n) provides:

> "Claims shall not be proved against a bankrupt estate subsequent to six months after the adjudication; * * *"

(Act of July 1, 1898, Sections 1, 17, 57 and 63; 30 Stat. 562, as amended; U. S. C., Title 11, Sections 1, 35, 93 and 103.)

Summary of Argument.

I.

In the recent case of *Manhattan Properties, Inc.* v. *Irving Trust Company,* 291 U. S. 320, this Court confirmed the long established doctrine that claims for rent or for damages for breach of rent covenants were not provable in bankruptcy. That rule was not to be avoided by mere resort to an express agreement to pay liquidated damages upon a stipulated *ipso facto* termination of the lease in the event of the filing of a petition in bankruptcy by or against the tenant, a conclusion confirmed by the recent legislative history of the Bankruptcy Act, and more particularly the amendments enacted in 1934.

(1) The *Manhattan Properties* decision.

(2) The rationale of the opinion below in the instant case is based upon the circumstance of an express covenant to pay damages.

(3) The result below is contrary to the trend of the decisions of this Court.

(4) The result below is likewise contrary to the trend of the decisions of the lower federal courts.

(5) Nor is there any logical reason why the inclusion of an express covenant should have created an exception to the general rule.

(6) Recent legislative history confirms it to have been the intention of Congress that there should be no such exception to the general rule.

(a) The Context of the Act of June 7, 1934.

(b) Congressional Reports.

(c) The Act of June 18, 1934.

II.

All other considerations apart, the instant clause would not, in any event, give rise to a provable claim.

(1) The minuend clause sounds in penalty and is therefore unacceptable.

(2) Nor is the subtrahend clause susceptible of valuation, and therefore of application.

(a) There is involved a month by month inquiry for the balance of the term, necessitating resort to speculation.

(b) Impossibility of valuation also ensues because of the lease provisions for termination and abatement of rent.

Argument.

I.

In the recent case of *Manhattan Properties Inc.* v. *Irving Trust Company*, this Court confirmed the long established doctrine that claims for rent or for damages for breach of rent covenants were not provable in bankruptcy. That rule was not to be avoided by mere resort to an express agreement to pay liquidated damages upon a stipulated *ipso facto* termination of the lease in the event of the filing of a petition in bankruptcy by or against the tenant, a conclusion confirmed by the recent legislative history of the Bankruptcy Act, and more particularly the amendments enacted in 1934.

Can a landlord and tenant turn an otherwise non-provable claim into a provable claim merely by stipulating that, in the event of bankruptcy of the tenant, the lease shall *ipso facto* terminate and the tenant thereupon be liable to pay liquidated damages?

This question, here presented, arises upon the following covenant in the lease at bar (R. 10):

> "* * * and, for the more effectual securing to the Lessor of the rent and other payments herein provided, it is agreed as a further condition of this lease that the filing of any petition in bankruptcy or insolvency by or against the Lessee shall be deemed to constitute a breach of this lease, and thereupon, *ipso facto* and without entry or other action by the Lessor, this lease shall become and be terminated; and, notwithstanding any other provisions of this lease, the Lessor shall forthwith upon such termination be entitled to recover damages for such breach in an amount equal to the amount of the rent

reserved in this lease for the residue of the term hereof less the fair rental value of the premises for the residue of said term."

The Circuit Court of Appeals, reversing the Referee and the District Court below, has held that this covenant gave rise to a provable claim, predicating its decision upon the ground of the presence of an express promise.

(1) *The Manhattan Properties Decision.*

The point of departure in any discussion of the provability of claims arising out of leases, either for rent or for damages for breach of a covenant to pay rent, is this Court's recent decision in the case of *Manhattan Properties, Inc.* v. *Irving Trust Company,* 291 U. S. 320.

Prior to that decision there had never been any express determination by this Court of the question of the provability of such claims. There had, however, grown up a great body of decisions in the lower federal courts wherein it was uniformly held that such claims were not provable. These decisions had been referred to with approval by this Court. Congress had remained inert although seven times during that period of time. (*Cf. Manhattan Properties* decision, at pp. 335-336.)

In consequence, this Court said that only compelling language in the statute itself would warrant the rejection of a construction so long and so generally accepted (p. 336).

It thereupon held that claims for future rent were not provable.

While it may be true that it was not dealing with a claim for damages for breach of a covenant to pay rent (for the indemnification clauses there at bar may not have been, strictly speaking, such covenants), the discussion in the Court's opinion of the historical and judicial genesis of the rule made no distinction between claims for future

rent and claims for damages for breach of covenant to pay rent. It not only made no distinction between the two, but expressly considered them to be correlative. We quote from the Court's opinion (pp. 333 *et seq.*):

> "The Act of March 2, 1867, §19, 14 Stat. 517, 525, authorized the proof and liquidation of contingent claims, and also proof of a claim for a proportionate part of any rent up to the date of bankruptcy. The courts uniformly held that claims for future rent or for *damages for breach of covenant to pay rent* were not provable under the act, though differing as to the reason; some holding them not contingent claims within the statutory definition, and others thinking the express permission of proof for rent past due at the date of bankruptcy impliedly excluded claims for rents thereafter falling due. (Cases cited.)
>
> "In the year 1880 Circuit Judge John Lowell, of Massachusetts, at the suggestion of several mercantile associations, drafted a proposed bankruptcy law, which, after revision, was introduced in Congress, but failed of passage. It contained a section (60) which allowed proof of damages sustained by reason of the trustee's rejection of a lease, and another (61) permitting any creditor to compel the trustee to elect to accept or decline any lease, and upon declination the landlord was to have *'any damages* he shall suffer thereby assessed, as the court shall direct, and prove the amount as a debt in the bankruptcy'.
>
> "After much agitation by trade associations and commercial bodies, and after prolonged consideration (see *Schall* v. *Camors,* 251 U. S. 239, 250), Congress adopted the Act now in force, that of July 1, 1898. The committee reports do not disclose the origin of the phraseology of §63, nor discuss the classes of claims intended to be included. But

> it is clear that Congress was familiar with analogous sections of the earlier Acts and the court decisions interpreting them, and with the text of the Lowell Bill and the English act then in force. *In view of the extended consideration and discussion which preceded the passage of the Act, the failure to include a provision for claims for loss of rent or for damages consequent on the abrogation of leases, is significant of an intent not to depart from the precedents disallowing them. Schall* v. *Camors, supra,* pp. 250, 251." (Italics by counsel.)

Among the cases thereupon cited by this Court as instances in which rent claims had been held non-provable, were *In re Roth & Appel,* 181 Fed. 667 and *Wells* v. *Twenty-First Street Realty Co.,* 12 F. (2d) 237*, where were presented claims for damages as distinguished from claims for future rent.

It is manifest, therefore, that regardless of the scope of the precise holding in the *Manhattan Properties* case, this Court had no intention of distinguishing generically between claims for future rent and claims for damages for breach of rent covenants**, nor is there any basis in the history of the doctrine, as is manifest from the opinion itself, to justify a distinction.

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* The facts of *Wells* v. *Twenty-First Street Realty Co.* are more fully reported in the decision in the District Court, *sub nom. In re Bissinger Co.,* 5 F. (2d) 106.

** We do not conceive that certain comments of the Court in its opinion were intended to constitute any qualification of the general doctrine enunciated. We refer to comments at pages 337 and 338. At page 337 the Court remarks of the indemnity covenants there at bar that they do not provide for liquidation of damages, nor indeed for any right to damages for breach of the covenant to pay rent. At page 338 the Court says:

> "Such a covenant is not, as petitioners contend, the equivalent of an agreement that bankruptcy shall be a breach of the lease and the consequent damages to the lessor be measured by the difference between the present value of the remainder of the term and the total rent to fall due in the future."

Manifestly, these remarks were made in response to contentions of counsel as is apparent not only from the opinion itself, but also from that part of the summary of the argument of counsel printed at pages 324-325.

(2) *The Rationale of the Opinion Below in the Instant Case is Based Upon the Circumstance of an Express Covenant to pay Damages.*

Not only did this Court in the *Manhattan Properties* case make no distinction between claims for future rent and claims for damages for breach of rent covenants, but the court below in the instant case likewise felt that no distinction was to be made (see R. 32-33).

In fact, apropos claims for damages for breach of rent covenants it said (R. 33):

> "It is the uncertainty in fact of the loss that invalidates the claim; that is not remedied by an approximation which the law will accept in other connections."

Clearly, the court below conceived that claims for rent and claims for damages for breach of rent covenants stood on the same basis; both were unacceptable. What then was the basis for its decision?

Simply that there had been included in the lease an express covenant to pay damages.* The court below regarded the existence of such a covenant as a sufficient justification for the creation of an exception to the general rule, for it went on to say (R. 33):

> "But when the parties have agreed that the lessee shall pay a sum to be ascertained by an accessible standard, the bankruptcy court is not liquidating a future loss at all; in its place the parties have substituted a promise, which does not look to the future,

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* Of the provision that the lease should *ipso facto* terminate in the event of the filing of a petition in bankruptcy, the court below briefly remarks that in consequence the claim "is not contingent in right" (R. 32). In other words, if there would be otherwise a provable claim, it would be due at the time of the filing of the petition. The court below does not suggest that that fact alone would give rise to a provable claim nor could such a result be conformed to the holding of this Court in *Gardiner* v. *Butler & Co.*, 245 U. S. 603, 605. See also *Wells* v. *Twenty-first Street Realty Co.*, *supra*.

> which is to pay the difference between two amounts presently ascertainable. The only question is whether that promise is lawful, whether it makes a contract, and as to that we have it on the highest authority that it liquidates 'the damages upon a footing familiar and fair'. *Filene's Sons* v. *Weed*, 245 U. S. 597, 602."

In other words, the court below has said, that while the measure of damages stipulated at bar would have been only a forecast, and so unacceptable, in the absence of an express covenant, the stipulation of the parties to pay, although by an otherwise unacceptable standard, renders the claim acceptable.

No authority was cited in support of this novel circumscription of the rent doctrine. The reference by the court below to *William Filene's Sons Co.* v. *Weed* was limited to the fairness of the measure of damages expressed.

That the court below remained in grave doubt, even after its decision, as to the correctness of the result in the instant case, would appear from the following comment in its opinion in *Wright* v. *Irving Trust Company*, 70 F. (2d) 245, a case decided subsequently to that at bar, where the same judge who wrote the opinion below said, in speaking of the *Manhattan Properties* decision (pp. 245-246):

> "As we understand it, the invalidity of rent claims is not deduced from the statute, but is a historical exception; the earlier acts by judicial construction had refused to allow claims for future rents, even when contingent claims were provable; although such claims are now generally provable, not only did Congress fail to include rents in 1898, but it continued inert through many amendments, in spite of a number of decisions in accord with the earlier interpretation. *It is not altogether plain how we ought to circumscribe such a doctrine; how far it should be limited to the occasions which have heretofore arisen;*

> *how far we should rationalize it in the interest of convenience in application."* (Italics by counsel.)

(3) *The Result Below is Contrary to the Trend of the Decisions of this Court.*

As we have said, the philosophy of the *Manhattan Properties* case was that claims predicated upon rent stood apart as a matter of well-defined historical development, acquiesced in by Congress. The distinction being historical, coordination of the doctrine with cases affecting personalty is futile. Sixteen years ago this Court said in *Gardiner* v. *Butler & Co.*, 245 U. S. 603, 605:

> "But the law as to leases is not a matter of logic *in vacuo;* it is a matter of history that has not forgotten Lord Coke."

In that case, an equity receivership, this Court denied relief for damages upon a basis somewhat similar to that at bar, where the lease did not contain any clause providing for such damages.

In the same equity proceeding, and as a companion decision, this Court rendered its opinion in *William Filene's Sons Co.* v. *Weed, supra.* There was there an express covenant for the payment of damages upon a real estate lease, to wit, the difference between the rental value at the date of entry and the rent reserved, which, having been contracted for, the Court felt should be paid.

This conclusion at first blush would appear to support the result here at bar. However, an accurate analysis of the *Weed* case and proper regard for the careful language of the eminent jurist who wrote the opinion, point to exactly the contrary result in the instant case.

The claimant in that case had subleased the property there involved to the defendant corporation in receivership, under a lease which required the sub-lessee to pay as rent all sums payable by the lessor under the over-lease to it,

plus twenty thousand dollars a year for the residue of the term. The lease contained the usual provision for re-entry in the case of failure to perform any covenant, of bankruptcy or of a receiver being appointed and not discharged within ninety days, and provided that upon a termination of the lease the lessee should pay the lessor said sum of twenty thousand dollars yearly for the residue of the term and as damages the difference between the rental value and the rent and other payments named in the lease for the residue of the term, less the yearly payment of twenty thousand dollars. The lessor filed a claim in the receivership proceeding for the yearly payments, discounted, and the stipulated damages, which was expunged by the lower courts which, in the language of this Court (p. 600),

> "were of opinion that the twenty thousand dollars were simply an addition to the rent, that the provisions for payment upon termination of the lease were an attempt to secure a preference by accelerating the instalments and also were in the nature of a penalty, *that the analogy of bankruptcy applied,* and that the claim for the above-mentioned items could not be allowed. The Circuit Court of Appeals seems to have considered also that the filing of the bill had the same effect as a petition in bankruptcy in stopping claims that like this were not provable at that date." (Italics ours.)

In reversing the decree below this Court said (p. 601):

> "We perceive no ground that would justify the rejection of the petitioner's proof for the whole sum subject to the discount agreed. Certainly the fact that the termination of the lease happened after the filing of the bill has no such effect, although the sum was not presently payable until then. When a statutory system is administered the only question for the courts is what the statutes prescribe. *But when the*

courts without statute take possession of all the assets of a corporation under a bill like the present and so make it impossible to collect debts except from the court's hands, they have no warrant for excluding creditors, or for introducing supposed equities other than those determined by the contracts that the debtor was content to make and the creditors to accept. In order to make a distribution possible they must of necessity limit the time for the proof of claims. But they have no authority to give to the filing of the bill the effect of the filing of a petition in bankruptcy so as to exclude any previously made and lawful claim that matures within a reasonable time before distribution can be made. *Pennsylvania Steel Co.* v. *New York City Ry. Co.*, 198 Fed. Rep. 721, 740, 741. Of course it does not matter that the claim was perfected by the petitioner's act, after a default in the rent. The receivers would not, and Butler & Company could not pay it, so that all agree that the petitioner's course was the prudent and only possible course to take, as it was the course that was contemplated by the covenant in the lease. * * *

"The rest of the claim is for damages *ultra* the twenty thousand dollars a year—the difference between the rental value at the date of entry and the rent reserved, less the amount received under the twenty thousand dollar clause. *This also was contracted for* and we see no reason why it should not be paid." (Italics ours.)

We have quoted at some length from the opinion in order to make manifest the *ratio decidendi* of that case.

It was clearly the Court's holding that that case was to be distinguished from a bankruptcy proceeding, for the reason that, having taken possession of all of the assets of the defendant corporation, not under a statute but under a bill in equity, the courts "have no warrant for excluding cred-

itors, or for introducing supposed equities other than those determined by the contracts that the debtor was content to make and the creditors to accept". In other words, it having been so covenanted between the parties, the equity court was compelled to give effect to the agreement made. In consequence, it could not stop short at the date of the filing of the bill in equity, nor could it refuse to render damages (as it did in the companion *Gardiner* case), because a claim therefor "*also* was contracted for". The result with respect to the claim for damages cannot be divorced from the general comment that courts of equity "have no warrant for excluding creditors, or for introducing supposed equities other than those determined by the contracts that the debtor was content to make and the creditors to accept". This is obvious from the phrase with respect to damages,—"This *also* was contracted for".

The conclusion is inescapable that a like result would not have been achieved in bankruptcy. We have this Court's own authority in respect of the effect of the filing of the petition, for in the *Manhattan Properties* decision, *supra*, this Court excluded claims based upon covenants for indemnification effective only after the date of the filing of the petition in bankruptcy. No logical warrant exists for postulating a different result in respect of the claim for damages, since both are interwoven by the express language of the opinion itself in the *Weed* case.

In *Central Trust Co.* v. *Chicago Auditorium Association*, 240 U. S. 581, there was held provable a claim for damages upon a basis similar to that at bar, with respect to a contract for the baggage and delivery privilege of the Auditorium Hotel in Chicago, even though the contract contained no express covenant for liquidation of damages. The Court, however, was careful to distinguish between that case and a case "arising out of the relation of landlord and tenant", mentioning among cases of the latter class *Watson* v. *Mer-*

rill, 136 Fed. 359, where was involved a claim for damages for breach of a rent covenant (pp. 589-590).

Again, in *Maynard* v. *Elliott,* 283 U. S. 273, this Court sanctioned a claim against the bankrupt, as an endorser, upon certain notes not yet matured or dishonored, but again adverted to the fact that some contingent claims are deemed not provable, citing as an example *Atkins* v. *Wilcox,* 105 Fed. 595, involving a claim for notes given for future rent.

We have heretofore referred to four leading decisions of this Court, *i. e., Gardiner* v. *Butler, Wm. Filene's Sons Co.* v. *Weed, Central Trust Co.* v. *Chicago Auditorium Association,* and *Maynard* v. *Elliott.*

These four decisions are all mutually consistent, and, with the *Manhattan Properties* decision, may be rationalized as follows:

In equity receivership proceedings the courts, not dealing with a statutory system, but acting purely by virtue of their inherent chancery powers, must give effect to contracts as written by the parties.

In bankruptcy the court is dealing with a statutory system, and can allow only such claims as the statute permits.

The bankruptcy statute generally permits proofs of claim for anticipatory breaches of contracts, but, as a matter of historical distinction sanctioned by long legislative history, claims for rent and claims for damages for breach of covenants to pay rent have not been provable.*

In equity there may be a distinction between the making and the absence of a promise. In bankruptcy the distinction has to do with the *subject-matter.*

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* By virtue of the amendments effected by the Acts of June 7, 1934 and June 18, 1934, rent claims hereafter will be provable within rigid limitations. These amendments and their effect as confirming the result of the *Manhattan Properties* decision are hereafter considered (pp. 26-33).

(4) *The Result Below is Likewise Contrary to the Trend of the Decisions of the Lower Federal Courts.*

The distinction in bankruptcy above adverted to, that is, *of type and not of promise,* was pointed out almost thirty years ago in *Watson* v. *Merrill, supra,* in an opinion of the Circuit Court of Appeals for the Eighth Circuit, written by the late Judge Sanborn, Mr. Justice (then Circuit Judge) Van Devanter sitting, where it was said (p. 360):

> "It is, however, the *nature* of the claim, and not the name which is applied to it, *that conditions its provability in bankruptcy.*" (Italics ours.)

Exemplification of this distinction in bankruptcy is to be found in the cases dealing with promissory notes not matured at the date of the filing of the petition in bankruptcy. Notes given for rent have stood apart.

The Circuit Court of Appeals for the Seventh Circuit held, in *In re Wisconsin Engine Co.,* 234 Fed. 281, that negotiatiable promissory notes maturing subsequent to bankruptcy, given pursuant to a patent license agreement, gave rise to a provable claim, saying at page 284:

> "There is no guaranty that, if royalties shall in fact become due, they shall amount to at least $22,500 for the period; there is an absolute undertaking that this amount shall be paid. While the mere giving of notes to evidence or in prepayment of a clearly conditional obligation would not annul the condition *or make an otherwise unprovable claim allowable in bankruptcy* (*Atkins* v. *Wilcox,* 105 Fed. 595, 44 C. C. A. 626, 53 L. R. A. 118), the provision that notes should be given and that they should be negotiable is additional evidence tending to resolve any doubt as to the intention of the parties that the amount therein stated was to be payable in any event. That

> the notes were not in fact sold is of no moment. The parties necessarily contemplated that they might be negotiated." (Italics ours.)

The case referred to by the court, *Atkins* v. *Wilcox*, presents the antithesis. There notes were given for future rent. The tenant having become bankrupt during the term of the lease, a claim was filed by the landlord for the full amount of the notes, including those for months subsequent to the bankruptcy.

The Circuit Court of Appeals expunged the claim, remarking at page 598:

> "In the opinions of the referees and of the judges of the courts of bankruptcy, just referred to, there is a marked unanimity to the extent that rent to accrue in the future, if it can be called a debt, is a contingent one, both as to its amount and as to its very existence, and that there is no provision in the act of 1898 which allows proof of such debts."

It is manifest from the opinion in *Atkins* v. *Wilcox*, that it was the intention of the parties that these notes should be paid in any event since the lease contained the following provision:

> "Should the lessee at any time fail to pay the rent punctually at maturity as stipulated, the rent for the whole unexpired time of this lease shall, without putting said lessee in default, at once become due and exigible" (p. 597).

In both the *Wisconsin Engine Co.* case and in *Atkins* v. *Wilcox* it was the intention of the parties that the amount of the notes should be payable in any event. Yet, in the former case the notes were held to constitute a basis for a provable claim; in the latter case, which was expressly

referred to in the *Wisconsin Engine* case, the notes were held *not* to afford a basis for a provable claim.

We submit that the signing of the notes was as much an express covenant to pay as the language contained in the lease at bar. Yet the test adopted in the two cases just cited was one of type and not of promise. Where there was not involved a non-provable type of claim, the promise contained in the notes was enforced. Where the case did involve a non-provable type, the promise was not enforced, the court pointing out in the *Wisconsin Engine* case that the giving of notes "would not * * * make an otherwise unprovable claim allowable in bankruptcy" (p. 284).

The decision in *Atkins* v. *Wilcox,* which was rendered shortly after the enactment of the Act of 1898, and while its interpretation was unsettled, still remains good law. It has been referred to by this Court in *Maynard* v. *Elliott, supra,* and *Manhattan Properties, Inc.* v. *Irving Trust Company, supra.*

Where the question has arisen, *Atkins* v. *Wilcox* has been consistently followed by the lower federal courts. See *In re Hays, Foster & Ward Co.,* 117 Fed. 879 (D. C. W. D. Kentucky, 1902); *In re Sterne & Levi,* 30 A. B. R. 915 (not officially reported; Referee's Opinion U. S. D. C. E. D. Texas, 1912). The same result was reached in *In re Curtis,* 109 La. 171, 9 A. B. R. 286, a case arising in the Supreme Court of Louisiana. In these cases the courts refused relief to the claimant, in the face of an express promise to pay, solely because the notes were given for future rent. In other words, the courts disregarded the element of promise, and regarded solely the type of claim.*

* There is the added factor in the instant case that, unlike the note cases just referred to, the provision at bar was written solely in contemplation of bankruptcy, when the lessee's assets would be distributed to his creditors, and where the lessee himself, in the language of this Court in *Kothe* v. *R. C. Taylor Trust,* 280 U. S. 224, 226, "had little, if any, immediate concern with the amount of the claim to be presented."

As was pointed out in the *Manhattan Properties* decision, it was the uniform holding of Federal courts that claims for *damages* consequent on the abrogation of leases (as well as claims for rent) were not provable in bankruptcy. Such were the holdings in *In re Roth & Appell, supra*; *In re Blum Bros. Co.*, 55 F. (2d) 723 (D. C. S. D. Ohio); *Watson* v. *Merrill, supra*; *In re Service Appliance Co.*, 45 F. (2d) 884 (D. C. N. D. N. Y.); *Matter of Bliss Auto Sales Company*, 22 A. B. R., N. S. 44 (not officially reported; D. C. N. D. Ohio, Western Division), and *Wells* v. *Twenty-First Street Realty Co., supra.*

In *Matter of Bliss Auto Sales Company*, we find the explicit holding that even an express covenant will not create an exception in a rent case. There the lease contained a covenant that, if the lessee should be adjudged a bankrupt, the lessor might re-enter, and the "lessor shall have the right to recover from the lessee any and all damages which it may sustain by reason of the failure on the part of the lessee to complete and carry out the terms and conditions hereof." It was expressly contended by counsel that the existence of this covenant was a factor distinguishing that case from the usual rent case. It was, nevertheless, held that the claim for damages for the breach of the lease was not provable.

It is quite obvious that the *Bliss Auto Sales Company* case might readily have been disposed of as were the claims in the *Manhattan Properties* case, upon the ground that the covenant for damages could not become effective until after the date of the filing of the bankruptcy petition. No such approach was adopted by the court. It proceeded solely upon the basis that, being a claim for damages for rent, it was a type of claim which was not provable in bankruptcy, the inevitable result being a disregard of the express covenant of the lease on that sole ground.

It was remarked, by way of dictum, in *Watson* v. *Merrill, supra* (p. 362):

> "Moreover, if by *contract* or by virtue of legal proceedings the lessor became entitled to the possession of the premises, and also to the difference between the amount which he might secure from another tenant, or the rental value of the leasehold, and the rents reserved, that amount would always be uncertain and contingent upon future events." (Italics ours.)

The Circuit Court of Appeals for the 1st Circuit in *R. C. Taylor Trust* v. *Kothe,* 30 F. (2d) 77, gave effect to a provision of a covenant in a lease which provided that, in the event of bankruptcy, it should *ipso facto* terminate and the lessor should forthwith "be entitled to recover damages for such breach in an amount equal to the amount of the rent reserved in this lease for the residue of the term hereof." The prevailing opinion, however, contains no discussion of the point at issue, but concerns itself solely with the question as to whether the claim was provable because not arising until the filing of the petition, and whether or not the measure of damages constituted a penalty. That case was reversed by this Court, *sub nom. Kothe* v. *R. C. Taylor Trust, supra,* on the sole ground that the provision did constitute a penalty. That this Court did not advert to the provability of the claim generally as a matter of bankruptcy law can create no inference one way or the other. The decision preceded the *Manhattan Properties* case, and there was no reason why this Court should then discuss the larger question of the provability of rent claims (which it had then not yet decided), much less the smaller question of the effectiveness of the express covenant, in view of the circumstance that under no consideration could the claim there presented be allowed.

The trend of the lower federal courts has therefore been to condemn claims for damages for breach of rent covenants as well as claims for future rents, and to give no effectiveness to a covenant in the lease for the payment of damages.

(5) *Nor Is There Any Logical Reason Why the Inclusion of an Express Covenant Should Have Created an Exception to the General Rule.*

Prior to the *Manhattan Properties* case, a frequently ascribed reason for the principle denying the provability of rent claims was their contingency. *Atkins* v. *Wilcox, supra, In re Roth & Appell, supra*; and see *Maynard* v. *Elliott, supra*, at page 278.

The *Manhattan Properties* decision rests the doctrine upon historical grounds, the view thereafter taken by the court below in *Wright* v. *Irving Trust Company, supra.*

In seeming consistency with these principles the opinion below said of the formula in the instant lease:

> "If the calculation be too contingent for a bankruptcy claim when there is no covenant, why is there* not when there is? This argument loses sight of the real objection to allowing the claim when damages have not been liquidated. That is not because the rule for measuring damages is too vague or uncertain to be manageable in bankruptcy; but that, though it is the best approximation available, it is still only a forecast, and a forecast in these circumstances will not do for bankruptcy which is more rigid as to such issues than other proceedings, an action at law, for example. It is the uncertainty in fact of the loss that invalidates the claim; that is not remedied by an approximation which the law will accept in other connections." (R. 33).

* So in original.

What the court below must have meant by this language was that a measure of damages of the type at bar, when not expressly covenanted for, would not be enforced in bankruptcy, not because it was necessarily incapable of ascertainment, but because it was barred by the arbitrary differences existing in bankruptcy.

The making of an express promise to pay upon the otherwise condemned basis would seem to afford no justification for tempering the historical rigidity of the bankruptcy rule. The promise neither facilitates the operation of the machinery of the bankruptcy courts, nor changes the nature of the claim proposed for allowance.

The rule is founded upon an historical distinction between claims affecting landlord and tenant, and those affecting other relationships. Under such circumstances there is no reasonable justification, nor can any possible basis be found in the historical sanction for the rule, for disregarding the peculiarities of the landlord and tenant relationship simply because recourse has been had to an express covenant. Adhesion to such a distinction would be so startling as to be justified only by the most cogent reasoning and statutory and judicial warrant. All are lacking.

(6) *Recent Legislative History Confirms It to Have Been the Intention of Congress That There Should Be no Such Exception to the General Rule.*

Prior to the Act of March 3d, 1933 (47 Stat. 1467), which added to the Bankruptcy Act sections 73 to 76 inclusive, there was no specific mention in the Bankruptcy Act of claims for rent or for damages for breach of a covenant to pay rent. Section 74(a), which was one of the sections added by the Act of March 3d, 1933, provides:

> "* * * A claim for future rent shall constitute a provable debt and shall be liquidated under section 63(b) of this Act."

In response to the contention that this provision was merely declaratory of the law as understood by Congress, this Court said in the *Manhattan Properties* decision (at p. 337):

> "Sections 73 to 76 inclusive were enacted to permit extensions and compositions not theretofore possible. They apply only to individuals. It is highly unlikely that if the quoted sentence had been intended as an amendment of §63(a) it would have been placed in context dealing only with the novel procedure authorized by the new sections. Moreover, the discussion on the floor of the Senate relative to the insertion of the sentence, indicates that it was not intended to alter §63(a) as it then stood. The petitioners insist the clause is declaratory of the law, as understood by the Congress; but there is no evidence to support this view, and it is inconsistent with the long standing contrary judicial construction."

Subsequent to the decision in the *Manhattan Properties* case (handed down February 5, 1934) further substantial amendments to the Bankruptcy Act were made by Congress by the Act of June 7, 1934.* This Act, as here pertinent, added two amendments to the Bankruptcy Act.

One was an entirely new section known as section 77B, which made provision for the reorganization of corporations. Sub-section (b) thereof provides:

> "The claim of a landlord for injury resulting from the rejection of an unexpired lease of real estate or for damages or indemnity under a covenant contained in such lease shall be treated as a claim ranking on a parity with debts which would be provable under section 63(a) of this Act, * * *."

* Public Law No. 296, 73d Congress (H. R. 5884).

Of this amendment it may be said, as this Court said of section 74(a) in the *Manhattan Properties* case, that it was enacted to permit reorganizations not theretofore possible and that there is here likewise no evidence to support the view that the clause was merely declaratory of the law as understood by Congress.

In fact, these amendments would seem to indicate that Congress regarded it as necessary to *add* to the statute provisions for claims for future rent on the theory that they were not already in the statute.

However, whatever may be the conclusions to be drawn from the additions of sections 74(a) and 77B (b), any doubt is resolved by the other amendment effected by the Act of June 7, 1934, in the form of certain additions to section 63(a) of the Bankruptcy Act. This section of the Act is the one which enumerates debts which may be proved in ordinary bankruptcy proceedings, as distinguished from the new proceedings provided for by sections 73 to 76 inclusive and section 77B. Section 63(a) is the section which is pertinent to the instant claim inasmuch as the estate at bar was administered under the Bankruptcy Act as it was formerly constituted.

The Act of June 7, 1934 added to section 63(a) clauses 6, 6½ and 7 as follows:

> Debts of the bankrupt may be proved and allowed against his estate which are * * * (6) founded upon an award of an industrial accident commission, or other commission, body or officer, of any State or Territory having power or jurisdiction to make awards as workmen's compensation in case of injury or death for injury prior to adjudication; (6½) the amount of any damages, as evidenced by a judgment of a court of competent jurisdiction, in any action for negligence instituted prior to adjudication of defendant in such action in bankruptcy and pending at the time of the filing of petition in bank-

ruptcy, whether voluntary or involuntary; and (7) *claims for damages respecting executory contracts including future rents whether the bankrupt be an individual or a corporation, but the claim of a landlord for injury resulting from the rejection by the trustee of an unexpired lease of real estate or for damages or indemnity under a covenant contained in such lease shall in no event be allowed in an amount exceeding the rent reserved by the lease, without acceleration, for the year next succeeding the date of the surrender of the premises plus an amount equal to the unpaid rent accrued up to said date*: Provided, That the court shall scrutinize the circumstances of an assignment of future rent claims and the amount of the consideration paid for such assignment in determining the amount of damages allowed assignee hereunder: Provided further, That the provisions of this clause (7) shall apply to estates pending at the time of the enactment of this amendatory Act." (Italics ours.)

Clause (7), providing for rent claims, was intended to constitute a new and additional kind of debt which might be proved against the bankrupt estate. This is manifest from several considerations.

(a) *The Context of the Act of June 7, 1934.*

It is first manifest from the context. Workmen's compensation claims had never theretofore been provable in bankruptcy (*Lane* v. *Industrial Commissioner,* 54 F. (2) 338, 342, certiorari denied on jurisdictional grounds, 286 U. S. 543). Similarly, damages for tort injuries based upon negligence had never theretofore been provable except where reduced to judgment prior to the filing of the petition in bankruptcy (*Schall* v. *Camors,* 251 U. S. 239). Both types of claim are made provable by the new clauses (6) and (6½) respectively. Immediately following these two new

types of provable debts comes the new clause (7), making provision for claims based upon "executory contracts including future rents".

Moreover, such future rent claims are to be provable "whether the bankrupt be an individual or a corporation". Yet, as we have seen, Congress had already made provision for rent claims in section 74(b) in respect of extensions or compositions for individuals, and the amendment of June 7, 1934 was subsequent to the decision in the *Manhattan Properties* case, in which it was held that section 74(b) was not declaratory of the law as theretofore existing.

Again, the amendment limited proofs of debt by providing that such claims "shall in no event be allowed in an amount exceeding the rent reserved by the lease, without acceleration, for the year next succeeding the date of the surrender of the premises", of itself a novel limitation not theretofore found in section 63(a) or any other part of the Bankruptcy Act as formerly constituted.

(b) *Congressional Reports.*

That clause (7) was intended to constitute a new and additional kind of provable debt is further manifest from the Congressional reports.

Clause (7), although in briefer form, was in the Act of June 7, 1934 from the time it was first introduced in the House of Representatives as Bill No. 5884.* The Bill was referred to the Committee on the Judiciary, which submitted to the House a comprehensive report (Report No. 194, 73d Congress, First Session). The amendments to section 63(a), including clause (7), were referred to under the illuminating heading—*"Changes in Existing Law."* (Italics ours.)

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* Clause (7) in the original Bill read:

"Claims for damages respecting executory contracts including future rents whether the bankrupt be an individual or a corporation, which claims shall be liquidated under section 63(b) of this act."

House Report No. 194 was reprinted and submitted to the Senate in Senate Report 482 (73d Congress, Second Session) and therein adopted as part of the report of the Senate Committee.*

Finally, in the Statement of the Managers on the Part of the House, annexed to the Conference Report accompanying said Bill (H. R. Report No. 1773, 73d Congress, Second Session), appears the following statement with respect to clause (7) of section 63 (a):

> "As agreed upon by the conferees, *such claims are permitted to be provable claims*, provided that in no event shall a claim for damages be allowed in an amount exceeding the rent reserved by the lease for 1 year after surrender of the premises, plus the unpaid rent accrued to said date." (Italics ours.)**

It is therefore clear that it was the intent of both the House and the Senate to regard the amendments in question to section 63 (a), including clause (7), *as effecting changes in the law as it then existed.* In other words, there was no thought in either house of Congress that it was merely declaring the then present law.

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* The Senate Committee report recommended that in lieu of the words in 63 (a) (7): "which claims shall be liquidated under section 63 (b) of this act", there be inserted the words "but the claim of a landlord for anticipatory breach of an unexpired lease of real estate shall in no event be allowed in an amount exceeding the rent reserved by the lease for the year next succeeding the date of the surrender of the premises."

** The Conference Report recommended, in lieu of the amendment contained in Senate Report 482, the following: "but the claim of a landlord for injury resulting from the rejection by the trustee of an unexpired lease of real estate or for damages or indemnity under a covenant contained in such lease shall in no event be allowed in an amount exceeding the rent reserved by the lease, without acceleration, for the year next succeeding the date of the surrender of the premises plus an amount equal to the unpaid rent accrued up to said date: Provided, That the court shall scrutinize the circumstances of an assignment of future rent claims and the amount of the consideration paid for such assignment in determining the amount of damages allowed assignee hereunder: Provided further, That the provisions of this clause (7) shall apply to estates pending at the time of the enactment of this amendatory Act." The Bill was passed with this language.

(c) *The Act of June 18, 1934.*

That clause (7) was intended to constitute a new and additional kind of provable debt is finally manifest from the Act of June 18, 1934.

By the Act of June 7, 1934 the new clause (7) had been made applicable to estates pending at the time of the enactment of the Act. On June 18, 1934, there was passed a further amending Act which added at the end of clause (7) the words, "in which the time for filing such claims has not expired", so that the last sentence read:

> "Provided further, That the provisions of this clause (7) shall apply to estates pending at the time of the enactment of this amendatory Act in which the time for filing such claims has not expired."

Of this amendment Senate Report No. 1404 (73d Congress, Second Session) gave the explanation:

> "The committee is of opinion that the provisions of clause (7), quoted above, should be limited in operation to those estates in which the time for filing claims has not expired. If applied to estates in which the time for filing claims has expired, these provisions would entail much inconvenience, expense, and confusion, in many cases necessitating the reopening of estates which are ready for final settlement and in which the time for filing claims expired many months ago. The sole purpose of this bill (S. 3779) is to avoid such undesirable results of the provisions of clause (7)."

If clause (7) had been merely declaratory of the law as theretofore existing, the Act of June 18, 1934 would not have been necessary.*

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* The time for filing claims in the instant estate expired March 30, 1933, the date of adjudication having been September 30, 1932 (*cf.* R. 1; Bankruptcy Act, Section 57 (n)).

It therefore would seem obvious that clause (7) adds new matter to the Bankruptcy Act. It adds, among others, claims for damages respecting "executory contracts including future rents", and then goes on:

> "but the claim of a landlord for injury resulting from the rejection by the trustee of an unexpired lease of real estate or for damages or indemnity under a covenant contained in such lease"

shall be limited as provided.

Congress therefore used the words "claims for damages respecting executory contracts including future rents" to mean, among other things, claims "for damages or indemnity under a covenant contained in such lease." What is to be particularly emphasized is that Congress expressly deemed that it was adding, as a theretofore non-provable claim, a claim for damages which arises from *a covenant in the lease.*

It must therefore have been the thought of Congress that claims for such damages, even though expressly covenanted for, were not theretofore provable in bankruptcy.

It was pointed out by this Court in the *Manhattan Properties* decision (at p. 332) that the sole inquiry "is the intent of the Act."

In construing an act of Congress which has been amended subsequent to the inception of a controversy, resort may be had to future amendments in determining the intent of Congress existing prior to those amendments (*Cope* v. *Cope,* 137 U. S. 682; *Dunbar* v. *Dunbar,* 190 U. S. 340; *Wetmore* v. *Markoe,* 196 U. S. 68). In other words, the intent of Congress is not infrequently gauged from the vantage point of subsequently enacted legislation. So gauged, it is manifest that the existence of an express covenant in the instant lease added nothing to the substance or breadth of any claim upon such lease arising.

II.

All other considerations apart, the instant clause would not in any event give rise to a provable claim.

We now assume, for the purposes of the instant discussion, that a landlord and a tenant may turn an otherwise non-provable claim into a provable claim by the device of stipulating that, in the event of the bankruptcy of the tenant, the lease shall *ipso facto* terminate, and the tenant thereupon be liable to pay liquidated damages. The question is then presented as to whether the instant clause will serve.

It will be first observed that the clause at bar does not provide for liquidated damages in the strictest sense of the word. It rather provides for a formula by which the stipulated damages are to be ascertained. This formula consists of a minuend, to wit, "an amount equal to the amount of the rent reserved in this lease for the residue of the term hereof", and a subtrahend, to wit, "the fair rental value of the premises for the residue of said term." The figure resulting from the subtraction of the subtrahend from the minuend is to constitute the stipulated damages of the landlord.

It is of course obvious that if either the minuend or the subtrahend is unacceptable as a basis for a provable claim in bankruptcy, the formula itself is unacceptable. It is here contended that *both* the minuend and subtrahend clauses are unacceptable.

(1) *The Minuend Clause Sounds in Penalty and Is Therefore Unacceptable.*

As has been pointed out, the minuend clause of the formula is "an amount equal to the amount of the rent reserved in this lease for the residue of the term hereof."

There is no provision for discounting this figure to its present value. In consequence, the basic figure of the formula, being necessarily more than compensatory and therefore disproportionate to the loss, sounds as a penalty.

The court below was sensible of this difficulty, for it said (R. 33):

> "* * * but there is one doubt that does arise: whether the clause is for a penalty because the future payments are not discounted to their present values. If the lessee must pay at once the sum of a series of installments, each consisting of the difference between the rent reserved on successive rent days, and the estimated rent which will have been received on those days, the recovery will surely be more than compensatory. The present value of such an installment, payable twenty years hence, is very much less than its face."

The opinion then refers to this Court's decision in *Kothe* v. *R. C. Taylor Trust, supra,* in which a clause verbatim with the minuend clause at bar (there was however no subtrahend) was condemned as an unenforcible penalty, whose real design "was to insure to the lessor preferential treatment in the event of bankruptcy."*

The *Kothe* case dealt with a lease which had but fifteen *months* to run, and yet the provision for damages in the amount of the rent for those fifteen months was held to be "disproportionate to any damage reasonably to be anticipated in the circumstances disclosed."** Here the lease at the time of bankruptcy had upwards of twelve *years* to run.

That the purpose of the minuend clause here at bar was "to insure to the lessor preferential treatment in the event of bankruptcy" is made manifest from the fact that the cir-

* 280 U. S., at 227.
** 280 U. S., at 226.

cumstance which the lease provided should give rise to the so-called breach, and which would invoke its drastic formula for damages, bore no necessary reference to fault on the part of the tenant. Had an involuntary bankruptcy proceeding been filed against the tenant and subsequently dismissed for lack of merit, the formula for damages was nevertheless invoked. The tenant might not have been bankrupt and the petition against it most improvidently filed. Nevertheless, the lease would have come to an end, and the tenant would have been required to bear the burden of the formula. That such a result might ensue did not concern the landlord; his problem was to attempt to insure a claim provable in bankruptcy by making the date and filing of the petition the effective circumstance.

The decision below sought to avoid the result in the *Kothe* case by *interpreting into the language of the instant clause a discount provision*, the lease being thus allegedly construed in accordance with what the court below conceived to be "its patent general purpose to give the lessor indemnity and no more" (R. 34).

This Court did not attempt such a construction in the Kothe case, but condemned the clause as it was written. Nevertheless the court below, "to save the clause" (R. 34), supplemented the language of the lease at bar so as to hold that the proper measure of damages under its terms was "the sum of the *discounted* series of installments, each made up of the rent reserved, less the fair rental value for that period" (R. 34).

This was a result the court below was not free to reach, for, as was said by Mr. Justice (then Chief Judge) Cardozo in *Hermitage Co.* v. *Levine*, 248 N. Y. 333, 338:

> "If the damage clause as drawn gives inadequate protection, the fault is with the draftsman. The courts are not at liberty to supply its omissions at the expense of a tenant whose liability for the future

> ended with the cancellation of the lease except insofar as he bound himself by covenant to liability thereafter."

That language is applicable with even more force here, where the liability is that of the bankrupt's estate rather than that of the tenant personally, and where there are to be considered the interests of creditors rather than those of the tenant who made the promise.

We do not conceive that the subtrahend clause, even assuming it to be capable of application, can cure the vice in the minuend clause. The resultant figure after the application of the formula will always and necessarily reflect the excessive basis of the minuend clause.

(2) *Nor Is the Subtrahend Clause Susceptible of Valuation, and Therefore of Application.*

Even though we assume non-existent the vice of penalty in the minuend clause, there is encountered the insuperable difficulty of translating the subtrahend clause into a figure which may be used in the application of the formula.

In *Maynard* v. *Elliott, supra,* at page 278, the Court pointed out that not all contingent claims are provable, saying:

> "Or, the contingency may be such as to make any valuation of the claim impossible, *even though liability has attached.*" (Italics ours.)

There is not here presented a simple clause where the rental value of the premises is to be fixed as of a certain time, *e. g.,* the date of petition filed, or, as in *William Filene's Sons Co.* v. *Weed, supra,* the date of entry by the landlord. On the contrary, there is required to be subtracted from the minuend "the fair rental value of the premises for the residue of said term".

(a) *There Is Involved a Month by Month Inquiry for the Balance of the Term, Necessitating Resort to Speculation.*

If this subtrahend clause is to be interpreted as referring to the fair rental value as of the due date of each of the several instalments of rent, as would seem to be its meaning, the court will be projected into an inquiry which can only be resolved by the sheerest conjecture and speculation. The lease has twelve years to run. The rental is payable monthly (R. 7). Therefore in computing the subtrahend of the formula it will be necessary to make inquiry as to value for each of the monthly rent days for the twelve years to come.

The difficulties of such an inquiry were well stated by the court below itself in its decision in *In re Metropolitan Chain Stores, Inc.*, 66 F. (2d) 482, at page 484, where it was dealing with a claim for an anticipatory breach of a lease whose term had not begun at the date of petition filed. The court said (p. 484) that presumably the measure of damages would be "the difference between the rent stipulated in the lease and rent obtainable from other parties if the premises are relet" (*i. e.*, the rental value). The court continued:

> "In the case at bar the original term was not to begin until January 1, 1935, and was to run for thirty years thereafter. Whether during that distant period the landlord will profit or lose by reason of the prospective tenant's repudiation of his contract (assuming without decision that bankruptcy may be deemed such) is *pure speculation.*" (Italics ours.)

The application of such a formula readily seemed speculative to the court below where projected over thirty years. At bar it is only less so as a matter of degree. Valuation is impossible in either case, and hence in bankruptcy unacceptable.

(b) *Impossibility of Valuation Also Ensues Because of the Lease Provisions for Termination and Abatement of Rent.*

The fair rental value in the future cannot be estimated without also taking into consideration certain provisions of the lease *under which there may be no rent to pay.*

The lease provides (R. 9):

> "This Lease is made on condition that, in case the premises, or the estate of which they may form part, be in whole or in part destroyed or damaged by fire, or other unavoidable casualty, or if said estate be in whole or part taken by public authority for any public purpose, this lease may, at the election of the Lessor, be terminated; provided, that, if the same be not so terminated, a just and proportionate part of the rent shall be suspended or abated until the premises shall have been put by the Lessor in as good condition as at the date of such damage or taking; and the Lessee hereby assigns to the Lessor any and all claims and demands for damages on account of such taking."

In attempting to estimate the fair rental value of the premises month by month as instalments become payable in the future, it is inevitable that there be taken into consideration the fact that the payment of rent may be suspended or abated under the terms of the lease by the happening of any one of the several eventualities specified in the paragraph above quoted. Yet to do so is manifestly to make impossible any valuation of the claim.

The situation is much akin to that in *Dunbar* v. *Dunbar, supra,* where a claimant sought to prove against the estate of her bankrupt divorced husband a claim upon an alimony

agreement to pay her a stipulated sum "during her life, or until she marries". The court remarked (at p. 345):

> "But how can any calculation be made in regard to the continuance of widowhood where there are no tables and no statistics by which to calculate such contingency? How can a valuation of a probable continuance of widowhood be made? Who can say what the probability of remarrying is in regard to any particular widow? We know what some of the factors might be in the question; inclination, age, health, property, attractiveness, children. These would at least enter into the question as to the probability of continuance of widowhood, and yet there are no statistics which can be gathered which would tend in the slightest degree to aid in the solving of the question."

Like methods of calculation here are wanting as to destruction, or damage by fire or other unavoidable casualty, or condemnation by public authority, so that any basic certitude upon which could be predicated computation cannot be resorted to.

CONCLUSION.

It is respectfully submitted that the decision of the Circuit Court of Appeals for the Second Circuit should be reversed and the decision of the District Court of the United States, expunging the claim at bar, should be affirmed.

Respectfully submitted,

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MILTON SCHILBACK,
With Them on the Brief.

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CHARLES ELM

IN THE

Supreme Court of the United States

OCTOBER TERM, 1933.

No. [redacted] 22

IRVING TRUST COMPANY, as Trustee in Bankruptcy of Outfitters Operating Realty Co., Inc., a Delaware corporation,

Petitioner,

against

A. W. PERRY, INC., a Massachusetts corporation,

Respondent.

BRIEF OF THE RESPONDENT IN OPPOSITION TO THE PETITION FOR WRIT OF CERTIORARI

JOHN M. PERRY,
[redacted]
Counsel for Respondent.

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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1933.

No. 969.

IRVING TRUST COMPANY, as Trustee in Bankruptcy of Outfitters Operating Realty Co., Inc., a Delaware corporation,

Petitioner,

against

A. W. PERRY, INC., a Massachusetts corporation,

Respondent.

BRIEF OF THE RESPONDENT IN OPPOSITION TO THE PETITION FOR WRIT OF CERTIORARI.

Statement.

The statement of the matter set forth in the petition is substantially correct, except in one important respect. In summarizing the opinion of L. HAND, J. (R. 52-55) petitioner ascribes to the opinion the following holding (page 3 of the Petition):

> "* * * that, to avoid the possibility of the promise here made constituting a penalty, it was to be interpreted as providing for the discounting of the minuend, *i. e.*, the rent reserved for the residue of the term."

The opinion does not direct that either the minuend or the subtrahend (the fair rental value for the remainder of the term) be discounted. The measure of damages laid down is explicit and fair. The opinion states (R. 55):

> "* * * that the proper measure of damages is the sum of the discounted *series of* installments, *each* made up of the rent reserved, less the fair rental value for that period." (Italics ours.)

Opinions Below, Jurisdiction and Statute Involved.

The report of the opinions below, the jurisdiction of this Court and the statute involved have been fully set forth in the petition for the writ and the brief filed in support thereof.

Summary of Argument.

1.

The claim may be proved under Section 63 of the Bankruptcy Act.

2.

There is no historical basis for the disallowance of the claim.

3.

The Express Covenant of the lease requires the allowance of the claim.

4.

The damages measured in accordance with the provisions of the lease do not constitute a penalty.

5.

The fair rental value for the remainder of the term is readily ascertainable.

Reasons Why the Writ Should Not Issue.

The questions involved depend primarily upon the construction of a special covenant in a lease. By exercising jurisdiction in this case the Court will not dispose of any general questions affecting the allowance of claims in bankruptcy. This Court clearly intimated in *Manhattan Properties, Inc.* v. *Irving Trust Company,* 54 Sup. Ct. Rep. 385, that an agreement which made the filing of a petition in bankruptcy *ipso facto* a breach of the lease and in addition measured the damages by the difference between the rental value and the rent reserved, would be the basis of a provable claim. By allowing respondent's claim in the instant case the Circuit Court of Appeals has merely conformed to the views of this Court. The holding is not contrary either to statute or to prior decisions, but is in conformity therewith.

ARGUMENT.

1.

The Claim May be Proved Under Sec. 63 of the Bankruptcy Act.

The claim in the instant case is founded upon an express contract. By its terms the lease terminates *ipso facto* in the event of bankruptcy. The damages agreed upon in the lease are susceptible of liquidation. The claim is not contingent upon entry, reletting or any other contingency.

2.

There is no Historical Basis for the Disallowance of the Claim.

While it is true that the lower Federal courts in most circuits have repeatedly refused to allow claims for loss of future rentals, an examination of the cases indicates that the decisions were always for cogent reasons readily understandable. Sometimes reentry was doubtful; again the loss, if any, was not ascertainable or could not be definitely ascertained until the end of the term, or the measure of damages constituted a penalty. Nowhere was any definite rule laid down excluding claims for damages based on loss of rent, as such. In *Manhattan Properties, Inc.* v. *Irving Trust Company,* 66 F. (2d) 470, the Court of Appeals for the Second Circuit expressed the view, with apparent reluctance by the judge who wrote the opinion, that *In re Roth & Appell,* 181 Fed. 667, had become the settled law of the circuit. Yet the *Roth* case clearly suggested that the parties to a lease might agree that bankruptcy should terminate it and upon such termination all future installments of rent become, at once, due and payable. The measure of damages in *Kothe* v. *R. C. Taylor Trust,* 280 U. S. 224, followed this formula and was held, quite properly, to constitute a penalty. Finally this Court affirmed *Manhattan Properties, Inc.* v. *Irving Trust Company, supra,* yet went no further in discussing the trend of the decisions, than to say that it had not "expressed disapproval of the rulings of the great majority of the lower Federal courts."

The petitioner in the first point of its argument (p. 17), referring to the intent not to depart from the alleged precedents disallowing claims for damages based on loss of rents, quotes from the decision of this Court in the *Manhattan Properties, Inc.,* case, *supra,* as follows:

> "In this situation 'only compelling language in the statute itself would warrant rejection of a construction so long and so generally accepted * * *.'"

This Court quoted the above language from the opinion in *Maynard* v. *Elliott,* 283 U. S. 273. The court there was referring to a rule allowing claims predicated upon the liability of a bankrupt indorser of commercial paper which had not been "seriously challenged" for twenty-six years. Moreover, the Court qualified the requirement of "compelling language in the statute" by adding (p. 277):

> "* * * especially where overturning the established practice would have such far reaching consequences as in the present instance."

The distinction between the established liability of indorsers and that of parties to a lease, where the liability may be as broad as the language of the contract, is too obvious to discuss. No definite rule excluding all claims for damages based on loss of rent has ever been formulated, despite the trend of decisions in that direction. Hence the court below has not rejected any accepted construction of the law. Nor does the allowance of the claim in the instant case have any far reaching consequences since the lease stands on its own footing and is not a precedent for the allowance of other claims unless based on identical language.

It is difficult to perceive how the claim in the instant case can be disallowed, so clearly is it within the word of the statute and not contrary to settled law, unless, indeed, the courts are to legislate by judicial construction. Certainly, were the bankrupt an individual, the refusal to allow this claim would be extremely onerous upon the debtor. Since the debtor is a defunct corporation the rejection of the claim would have been an undue hardship upon the creditor.

3.

The Express Covenant of the Lease Justifies the Allowance of the Claim.

The petitioner argues (Point I, p. 17, of its brief) that the inclusion of an Express Covenant in the lease for damages is not sufficient reason for the allowance of the claim. But the petitioner bases its argument upon a misconception of the law. It refers to the allowance as "an exception to the general rule" although no general rule is shown unless numerous decisions each rejecting claims for specific, understandable and proper reasons, none of which are present in the instant case, can be said to establish a rule. And it characterizes the claim as "otherwise non-provable" except for certain important covenants. This argument is without force since admittedly the claim would be non-provable if it possessed the defects of, say, the claim in *Kothe* v. *R. C. Taylor Trust, supra.* We refer to the opinion of the court below quoted at page 19 of petitioner's brief as a complete answer to petitioner's objection.

4.

The Damages Measured in Accordance with the Provisions of the Lease do Not Constitute a Penalty.

In Point II of its brief (p. 24) petitioner contends that the minuend clause in the lease "sounds in penalty rather than liquidated damages." Petitioner refers to the decision of this Court in *Kothe* v. *R. C. Taylor Trust, supra.*

It is difficult to understand petitioner's argument in this respect except by reference to its misconception of the decision of the court below hereinbefore referred to in the statement in this brief (p. 1). Concededly, if the damages to be paid consisted of only the minuend, *i. e.*, the rent reserved for the balance of the term, this would

clearly constitute a penalty, under the *Kothe* case. But the damages are something very much less than the minuend alone. They consist of the minuend *minus* the subtrahend, with the series of remainders thus found (calculating the damages by years, or even by months) discounted to their value at the date of breach. In *William Filene's Sons* v. *Weed*, 245 U. S. 597-602, this Court said that the liquidation of damages in this manner was "upon a footing familiar and fair." Although the *Filene* case was one in equity, nevertheless this characterization of damages thus calculated, and the allowance thereof, is a holding by this Court that such damages do not constitute a penalty.

The court below did not read into the lease a provision for discounting the future rent because the clause as drawn was inadequate. Clearly the direction that the remainder ascertained by deducting the fair rental value from the rent reserved be discounted was nothing more than instructions as to the method of calculating the damages. As to the adequacy of the language of the lease, it is significant that it corresponds with exactness to the hypothetical case suggested by this Court in the concluding paragraph of its opinion in *Manhattan Properties, Inc.* v. *Irving Trust Company, supra.*

5.

The Fair Rental Value for the Remainder of the Term is Readily Ascertainable.

Petitioner contends (p. 27 of its brief) that even though liability has attached, the valuation of the claim may be impossible. It is suggested that a month-to-month inquiry for the balance of the term as to the fair rental value will be necessary. This, however, does not create any barrier provided testimony in this respect can be offered with fair certainty. As the property has been

leased again for a portion of the remaining term, the fair rental value of the whole of said term may be fixed without conjecture or speculation. Certainly the damages may be ascertained with equal, if not greater certainty, than was possible in *Central Trust Co.* v. *Chicago Auditorium,* 240 U. S. 581, where the value of a cab privilege was to be fixed, or *In re Marshall's Garage,* 63 F. (2d E.) 759, where the present valuation of land was accepted as a permissible subtrahend for calculating damages on a breach of contract to buy five years later.

The petitioner's brief (p. 28) refers to a provision of the lease under which the rent might be abated as creating a difficulty in fixing the fair rental value. This clause, however, is immaterial, since the parties have agreed on damages as the difference between two amounts presently ascertainable. The bankruptcy court is not required to liquidate a future loss, but merely to carry out the express contract of the lessee that it shall pay a sum to be ascertained by an assessable standard. The instant case cannot be compared with the facts in *Dunbar* v. *Dunbar,* 190 U. S. 340, where the Court was asked to speculate upon the probability of a widow remarrying. The citation of this case, so patently dissimilar to the present one is, we believe, evidence of the lack of force to the suggestion that the fair rental value for the balance of the term cannot be readily ascertained.

Conclusion.

The brief filed by the trustees of Louis K. Liggett Company *amici curiae* does not set forth the exact provisions of any of the four leases in that bankruptcy now awaiting determination in the lower court. It is not possible to conjecture, therefore, whether the granting of a writ in the instant case will have any bearing on the Liggett matter. The obvious purpose of the Liggett Trustees is to urge a drastic rule excluding all lessors as claimants

regardless of the covenants of the lease. Such rule would not serve the broad purpose of the Bankruptcy Act.

The *amici curiae* state (Point III of their brief) that the clause construed herein "is now in general use." This is hardly accurate since in the Liggett bankruptcy, involving four hundred leases, only four such claims are said to have possibilities of allowance. Indeed it is doubtful that many landlords would be content to so contract since contingencies might arise making such agreements particularly onerous for the lessor. Having so contracted they are entitled to the benefit of their agreement which clearly supports a provable claim.

The writ of certiorari herein sought should not be granted.

Respectfully submitted,

JOHN M. PERRY,
THOMAS F. DOUGHERTY,
Counsel for Respondent.

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CHARLES ELMORE

IN THE

Supreme Court of the United States

OCTOBER TERM, 1934.

No. 22.

IRVING TRUST COMPANY, as Trustee in Bankruptcy of Outfitters Operating Realty Co., Inc., a Delaware corporation,

Petitioner,

against

A. W. PERRY, INC., a Massachusetts corporation,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF OF RESPONDENT

ALBERT STICKNEY,
HERSEY EGGINTON,
THOMAS F. DOUGHERTY,
THEODORE PEARSON,
Counsel for Respondent.

W. FREDERICK KNECHT,
With Them on the Brief.

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No. 22.

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Petitioner,

against

A. W. PERRY, INC., a Massachusetts corporation,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF OF RESPONDENT.

Opinions Below.

Neither the opinion of the Referee (R. 13-23) nor the opinion of the District Court (R. 26) is reported in the Federal Reporter or Federal Supplement. The opinion of the United States Circuit Court of Appeals (R. 31-34) is reported at 69 Fed. (2d) 90.

Statement of Facts.

In 1929 the respondent, A. W. Perry, Inc., entered into a written lease with the bankrupt herein, Outfitters Operating Realty Co., Inc. (then known by its former name of Lerner Stores Corporation), by which respondent leased to the bankrupt certain premises at No. 459 Washington Street, Boston, Massachusetts, for a term expiring December 31, 1944 at a specified progressive rental (R. 6-11). The lease contained the following covenant (R. 10):

> "* * *; and, for the more effectual securing to the Lessor of the rent and other payments herein provided, it is agreed as a further condition of this lease that the filing of any petition in bankruptcy or insolvency by or against the Lessee shall be deemed to constitute a breach of this lease, and thereupon, *ipso facto* and without entry or other action by the Lessor, this lease shall become and be terminated; and, notwithstanding any other provisions of this lease, the Lessor shall forthwith upon such termination be entitled to recover damages for such breach in an amount equal to the amount of the rent reserved in this lease for the residue of the term hereof less the fair rental value of the premises for the residue of said term."

The bankrupt filed a voluntary petition in bankruptcy in the District Court of the United States for the Southern District of New York on September 30, 1932, and was adjudicated bankrupt on the same day (R. 1).

On March 29, 1933, the respondent filed its proof of claim in the sum of $177,788, based upon the provision

of the lease above quoted (R. 4-12). The petitioner, Irving Trust Company, as the Trustee in Bankruptcy, moved to expunge the claim and a hearing was had before the Referee at which it was stipulated that the question of the amount of the claim, if provable, was reserved and that the parties might thereafter offer testimony liquidating the amount, if any (R. 12-13).

The Referee expunged the claim (R. 13-23). On petition for review the order was affirmed by the District Court, in a memorandum decision by GODDARD, J., on the authority of previous decisions of the Circuit Court of Appeals for the Second Circuit (R. 26).

Upon appeal to that court the judgment of the District Court was reversed and the claim remanded for liquidation in accordance with the opinion of the Circuit Court of Appeals. The opinion by L. HAND, C. J., stated that this Court had held in *Manhattan Properties, Inc.* v. *Irving Trust Company,* 291 U. S. 320, that claims for future rent are ordinarily not provable and can become so, if at all, only by virtue of special clauses; that the question here was whether the instant clause would serve; that its possible validity was specifically reserved in this Court's opinion in the *Manhattan Properties* case; that the covenant in the instant lease avoided the objections that had invalidated claims under other covenants, since the claim was not contingent either in right or in amount at petition filed. The opinion recognized that under the authority of *William Filene's Sons Co.* v. *Weed,* 245 U. S. 597, the instant covenant liquidated "the damages upon a footing familiar and fair," but intimated some doubt whether the clause was for an invalid penalty

under *Kothe* v. *R. C. Taylor Trust,* 280 U. S. 224. The opinion expressly disclaimed decision of that question however, and, construing the damage clause in accordance with its patent general purpose to give the lessor indemnity and no more, held that "the proper measure of damage is the sum of the discounted series of installments, each made up of the rent reserved, less the fair rental value for that period."*

Certiorari was granted by this Court on May 14, 1934 (R. 37).

Statutes Involved.†

Section 63 of the Bankruptcy Act provides:

> "*Debts which may be proved.* (a) Debts of the bankrupt may be proved and allowed against his estate which are (1) a fixed liability, as evidenced by a judgment or an instrument in writing, absolutely owing at the time of the filing of the petition against him, whether then payable or not, with any interest thereon which would have been recoverable at that date or with a rebate of interest upon such as were not then payable and did not bear interest; * * * (4) founded upon an open account, or upon a contract express or implied; * * *.

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*The opinion did *not* interpret the clause as providing for discounting the *minuend, i. e.* the rent reserved for the residue of the term, as petitioner incorrectly states on page 3 of its brief.

†On June 7 and 18, 1934 (subsequent to the granting of certiorari herein), section 63(a) was amended by adding three new clauses thereto, which are relied on by petitioner only to show that it must have been the thought of Congress that claims for damages under covenants in leases were not theretofore provable. See Point V below (pp. 37-42).

(b) Unliquidated claims against the bankrupt may, pursuant to application to the court, be liquidated in such manner as it shall direct, and may thereafter be proved and allowed against his estate."

Section 1 (11) provides:

"'debt' shall include any debt, demand or claim provable in bankruptcy;"

Section 17 provides:

"A discharge in bankruptcy shall release a bankrupt from all of his provable debts" * * * with exceptions not here material.

(Act of July 1, 1898, Sections 1, 17 and 63, 30 Stat. 562, as amended; U. S. C., Title 11, Sections 1, 35 and 103.)

Question Presented.

Is the respondent's claim, founded on the express covenant contained in its lease to the bankrupt, a provable claim under section 63 of the Bankruptcy Act?

Summary of Argument.

The claim is founded upon an express contract, and is thus *prima facie* a debt of the bankrupt which may be proved and allowed against its estate under section 63 (a) (4) of the Act. Under the terms of the covenant the termination of the lease by way of conditional limitation gives rise to a claim for damages coincidentally

with the tenant's bankruptcy, and the damages so contracted for are ascertainable at the time of the bankruptcy. The claim is thus an existing liability at petition filed and is in its nature provable and allowable; all that remains is to liquidate the damages, if any, under section 63 (b) of the Act, in accordance with the presently accessible standard provided by the covenant.

Provability of the claim in bankruptcy is supported by the reasoning of this Court in *Manhattan Properties, Inc.* v. *Irving Trust Company, supra.*

There is no general rule in bankruptcy which excludes claims for damages under special covenants in leases. The provability of such claims depends on the terms of the particular covenant.

The inclusion of the special covenant may and does give rise to a provable claim.

The damage covenant in the lease is fair, and does not sound as a penalty whether or not the damages are discounted as directed by the court below.

The fair rental value for the residue of the term is readily ascertainable.

The recent amendments to the Bankruptcy Act do not affect the provability of the instant claim.

The decision of the Circuit Court of Appeals for the Second Circuit, remanding the claim for liquidation in accordance with its opinion, should be affirmed.

Argument.

I

The claim is founded upon an express contract, and is thus prima facie a debt of the bankrupt which may be proved and allowed against its estate under section 63 (a) (4) of the Act. Under the terms of the covenant the termination of the lease by way of conditional limitation gives rise to a claim for damages coincidentally with the tenant's bankruptcy*, and the damages so contracted for are ascertainable at the time of the bankruptcy. The claim is thus an existing liability at petition filed and is in its nature provable and allowable; all that remains is to liquidate the damages, if any, under section 63 (b) of the Act, in accordance with the presently accessible standard provided by the covenant.

Although the instant case is of first impression in bankruptcy, both in this Court and elsewhere, the principles applicable thereto have been enunciated by this Court in earlier decisions. The present inquiry is therefore to ascertain what the tests are of the provability of claims under damage covenants in leases, and to determine whether the instant claim meets those tests. The

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*The court below held that the claim was "not contingent in right, because the mere filing of a petition in bankruptcy puts an end to the lease" (R. 32). Petitioner does not question the correctness of this conclusion (see footnote on p. 13 of its brief), nor apparently do the *amici curiae* in support of petitioner.

provability of claims under damage or indemnity covenants has been before this Court in four cases, and only four. They are, chronologically:

William Filene's Sons Co. v. *Weed,* 245 U. S. 597 (1918);
Gardiner v. *William S. Butler & Co., Inc.,* 245 U. S. 603 (1918);
Kothe v. *R. C. Taylor Trust,* 280 U. S. 224 (1930);
Manhattan Properties, Inc. v. *Irving Trust Co.,* 291 U. S. 320 (1934).

The rationale of the *Filene* case (followed in the companion *Gardiner* case), in which a claim was allowed in an equity receivership under a damage covenant practically identical with that in the instant case,—and the reasoning of the *Kothe* and *Manhattan Properties* cases, in which claims were disallowed in bankruptcy solely because of defects in the covenants which here do not exist,—clearly establish principles which require that the instant claim be allowed. Respondent's claim meets the test of all four of these decisions.

We shall first consider the *Manhattan Properties* case, with some of the leading decisions of the lower Federal courts. The *Gardiner* and *Filene* cases are more particularly discussed under Point II below, and the *Kothe* case under Point III.

(a)

Provability of the claim in bankruptcy is supported by the reasoning of this Court in Manhattan Properties, Inc. v. Irving Trust Company.

Our case presents the question of whether a landlord may prove in bankruptcy for damages where the claim is founded upon the tenant's covenant that his bankruptcy shall be deemed a breach of the lease and entitle the landlord to damages equal to the rent reserved for the residue of the term less the fair rental value of the premises for the residue of the term.

In *Manhattan Properties, Inc.* v. *Irving Trust Co., supra,* at page 328, this Court began by saying:

> "These cases present the question whether a landlord may prove in bankruptcy for loss of rents payable in the future, where the claim is founded upon the bankrupt's covenant to pay rent, and, in the alternative, upon his breach of a covenant that in event of bankruptcy, the landlord may re-enter, and if he does, the tenant will indemnify him against loss of rents for the remainder of the term."

At the close of the opinion, after describing a covenant of the kind then at bar, the Court concluded as follows (p. 338-9):

> "Such a covenant is not, as petitioners contend, the equivalent of an agreement that bankruptcy shall be a breach of the lease and the consequent damages to the lessor be measured by the difference between the present value of the remainder of the term and the total rent to fall due in the future. The covenants appearing in the leases in question cannot be made the basis of a proof of debt against the estate."

The differences between the questions then and now before the Court are two:

(a) Here no argument is made that a landlord may prove for loss of future rents "where the claim is founded upon the bankrupt's covenant to pay rent." The first part of the *Manhattan Properties* opinion has disposed of that general question, in the negative.

(b) Here the covenant in the lease contains none of the provisions which influenced this Court, in considering "the effect of the indemnity covenants in the leases," to hold the claims in the *Manhattan Properties* decision non-provable. Those objectionable provisions, as itemized by the Court in the second part of the opinion (pp. 337-338), compared with the corresponding provisions in the instant covenant, are as follows:

In the Manhattan Properties case—	*In the instant case—*
The indemnity covenants did not provide "for liquidation of damages (compare *Wm. Filene's Sons Co.* v. *Weed, supra*), nor indeed for any right to damages for breach of the covenant to pay rent".	The covenant provides for liquidation of damages and for a right to damages, and the liquidation clause follows the identical principle of the clause upheld in the *Filene* case.
The landlord had the choice whether he would terminate the lease, though neither the bankrupt nor the trustee had any such option (except as the latter might disclaim).	The landlord does not have the choice whether he will terminate the lease, and so far as the covenant can provide the landlord, the bankrupt and the trustee are all treated on the same footing, by operation of the *ipso facto* clause.

In the Manhattan Properties case—

Upon the exercise of the landlord's option a new contract became operative, and there could be no color of a claim of anticipatory breach of this new contract of indemnity, since it came into being not by virtue of the bankruptcy but by force of the act of re-entry, which must occur at a date subsequent to the filing of the petition.

The indemnity contract could not be breached until the duty of indemnifying the landlord arose, which obligation could not be complete until the expiration of the original term.

In the instant case—

Whether or not the liquidated damage provision be considered as a new contract, there is no need for a claim of anticipatory breach, since the provision *does* become operative by virtue of the bankruptcy and *not* by force of the act of reentry or any other act which occurs at a date subsequent to the filing of the petition.

The damage contract is breached, and the obligation to the landlord arises and is complete, coincidently with the bankruptcy.

In short, as this Court said (p. 338):

> "There can be no debt provable in bankruptcy arising out of a contract which becomes effective only at the claimant's option and after the inception of the proceedings, the fulfilment of which is contingent on what may happen from month to month or up to the end of the original term." (citing cases)

The Court then concluded the opinion with the passage already quoted describing and distinguishing a type of covenant *identical with that involved in the present case.* If the covenants in the *Manhattan Properties* case had

met the objections which the Court enumerated, and if the covenants had been of the different type which the Court described, the conclusion is unescapable that the claims in the *Manhattan Properties* case would have been allowed.

(b)

There is no general rule in bankruptcy which excludes claims for damages under special covenants in leases. The provability of such claims depends on the terms of the particular covenant.

We should have supposed this proposition self-evident, and especially clear from the discussion in the second part of the *Manhattan Properties* decision as outlined above. If the Court had thought all such covenants ineffective it would presumably not have taken such pains to point out objections to the particular covenants then at bar, or to distinguish a form of covenant such as that involved in the instant case. However, as the *amici curiae* in support of petitioner expressly question the proposition (p. 15), and as both they and petitioner ground their case on the assumption that all claims under damage covenants are non-provable as a matter of bankruptcy law, we shall consider for the moment whether any possible authority for their position can be found. After all, if it appears that the courts treat each covenant on its own merits, we may properly conclude that the results would not have been achieved without recourse to some reason. And once the necessity for a reason is recognized, as distinguished from a historical rule without reason, very little of petitioner's case is left.

Petitioner has abandoned its contention in the court below (the Circuit Court of Appeals for the Second Circuit) that the instant claim is one for future rent; and the cases holding such claims not provable in bankruptcy are of course not relevant to the present question of a claim for damages under a special covenant in a lease. We may briefly point out, however, that the basis of those decisions was the nature of rent. Its peculiar character was well described in *In re Roth & Appel,* 181 Fed. 667 (C. C. A. 2nd, 1910), where the court began by saying, at page 669:

> "Rent is a sum stipulated to be paid for the use and enjoyment of land. The occupation of the land is consideration for the rent. If the right to occupy terminates, the obligation to pay ceases. Consequently, a covenant to pay rent creates no debt until the time stipulated for the payment arrives. The lessee may be evicted by title paramount or by acts of the lessor. The destruction or disrepair of the premises, may, according to certain statutory provisions, justify the lessee in abandoning them. The lessee may quit the premises with the lessor's consent. The lessee may assign his term with the approval of the lessor, so as to relieve himself from further obligation upon the lease. In all these cases the lessee is discharged from his covenant to pay rent. The time for payment never arrives. The rent never becomes due."

However, when we progress beyond the provability of claims for future rent as such to the provability of claims under express damage covenants in leases, we find that the difficulties which have confronted landlords in proving claims against bankrupt tenants have not

arisen from the law of real estate, but from the law of bankruptcy. The circumstance that the landlords' claims under covenants have been disallowed in the great numerical majority of decisions only goes to show that the great numerical majority of leases have not complied with the requirements of the Bankruptcy Act, as those requirements have been laid down by the courts. We do not find the courts disallowing such claims under covenants on any broad ground that all claims under covenants are non-provable, but on the ground that the covenant in the particular lease involved did not, for some specific reason or reasons, give rise to a debt of a kind which Congress intended to be provable in bankruptcy.

The grounds on which claims for damages, under special covenants in leases, have been held not provable in bankruptcy may on analysis be stated as two.* Avoiding extended citations, we shall again refer to *In re Roth & Appel,* where both were present. There a landlord sought to prove a claim under a lease which provided that upon the tenant's bankruptcy the landlord should have a right to re-enter, and that if the landlord did so the tenant would thereafter pay to the landlord "on the first day of each month, as upon rent days, the difference between the rents * * * agreed to be paid by the lessee and those otherwise reserved or with due diligence collectible." The court rightly refused to allow the claim, because it could not arise until after bankruptcy, saying (181 Fed. 667, 672):

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*The rejection of claims on the ground that they constitute penalties is of course not peculiar to bankruptcy and is treated in Point III below (pp. 26-34).

"Indeed, looking at the claim as it existed either at the time of the petition or the adjudication, it was altogether contingent in its nature:

(1) It was uncertain, as just pointed out, whether the lessor would re-enter and terminate the lease.

(2) In case the lease was terminated, it was uncertain whether there would be any loss in rents. If the rent received by the landlord from the new tenant equaled or exceeded that stipulated in the lease, there would be no loss, and, consequently, no foundation for any claim upon the indemnity covenant."

With no prohibition of statute or decision against doing so, the parties to the lease now in question advisedly contracted for a measure of compensation commensurate with such loss as the landlord might suffer in the event of his tenant's bankruptcy. This was done by the covenant now to be construed providing in certain and definite language and by way of limitation that the term or estate should be instantly determined by and upon the happening of bankruptcy and that a fixed liability, for a certain or presently ascertainable sum, should then arise and exist. The intention was by a free contract to avoid the cases which rejected landlords' claims on the grounds stated in *In re Roth & Appel,* or on the ground that the damages agreed upon involved an improper penalty. Thus by the general law applicable to the relation of landlord and tenant there conclusively arose an existing liability upon an express contract which indisputably comes within the definition of provable claims found in section 63 (a) (4) of the Bankruptcy Act.

Not only have the courts, in disallowing claims under covenants in leases, confined their reasons to factors not now present, but they have also often expressly indicated that covenants might well be made which would give rise to provable claims. Thus, in *In re Roth & Appel, supra,* a case repeatedly cited, the court said (181 Fed. 667, 671):

> "Undoubtedly the parties to a lease may agree that bankruptcy shall terminate it, and that, upon such termination, all future installments of rent shall at once become due and payable. In such a case, the installments may be regarded as consolidated by the contract, or, perhaps, as falling due by way of penalty. Not improbably claims based upon such leases are provable in bankruptcy."

(Damages contracted for on such a basis were disallowed in *Kothe* v. *R. C. Taylor Trust, supra,* but only on the ground that they constituted a penalty.)

In re Ells, 98 Fed. 967 (D. C. Mass., 1900), was one of the first cases decided under the present Bankruptcy Act; it was cited by this Court in the *Manhattan Properties* case both in its discussion of the general question and in demonstrating the defects of the particular indemnity covenants there involved. Notwithstanding that Congress had failed to include any provision expressly allowing proof of damages suffered by landlords, Judge LOWELL said in disallowing the claim, which was under an indemnity covenant effective upon re-entry (p. 969):

> "Doubtless, the covenant might have been expressed otherwise. If the debtor in this case had made a contract to take a lease at a fixed rent, and

> had broken the contract by refusing to execute the lease, damages for the entire breach could have been recovered at once, and might perhaps have been estimated at the difference between the rent stipulated in the contract and the rental value of the premises. A covenant in a lease might be worded expressly to require the lessee, in case of re-entry, to pay at once damages calculated upon this basis."

In *In re McAllister-Mohler Co.*, 46 Fed. (2d) 91 (D. C. S. D. Ohio, 1930), the court expressed a similar opinion in commenting upon *William Filene's Sons Co.* v. *Weed, supra,* and *Gardiner* v. *William S. Butler & Co., Inc., supra,* saying at page 95:

> "These cases are a complete answer to the contention that, if a landlord cannot prove a claim for anticipatory breach of a lease, he is remediless, for it is clearly within his power to protect himself by an appropriate clause in the lease."

We know of no authority to support the position that all claims for damages under special covenants in leases are non-provable in bankruptcy. Nor do we find any such authority cited in the briefs of the petitioner and the *amici curiae* in its support. They seek, however, to deduce such a conclusion from that part of the opinion of this Court in the *Manhattan Properties* case which dealt with the general question there presented, namely, "whether a landlord may prove in bankruptcy for loss of rents payable in the future, where the claim is founded upon the bankrupt's covenant to pay rent". Throughout the Court's discussion of that question there is not one word about special covenants for damages. The part of the opinion which dealt with the specific

question—"the effect of the indemnity covenants in the leases"—petitioner dismisses with a footnote (p. 12).

As the court below has said, the possible validity of the clause now involved "was specifically reserved in the Supreme Court's opinion" in the *Manhattan Properties* case. The *amici curiae* assert, however (p. 11), that the instant claim cannot be provable unless the *Manhattan Properties* case is reversed and a certain quotation therefrom (discussing the general question) is substantially modified. We are at a loss to understand on what basis such an assertion could be made, unless it were placed on the ground that the Court's entire discussion of the specific question, and particularly its closing statements, were an egregious and misleading dictum.

Finally, as petitioner and the *amici curiae* in its support are themselves only too eager to emphasize, "The sole inquiry is the intent of the Act." Having so said this Court in the *Manhattan Properties* case examined the earlier bankruptcy statutes and the discussion which preceded the passage of the present Act, and concluded that "the failure to include a provision for claims for loss of rent or for damages consequent on the abrogation of leases, is significant of an intent not to depart from the precedents disallowing them" (291 U. S. 320, 335). The Court then pointed out that such claims had been held not provable debts in the well-nigh unanimous view of the Federal Courts reiterated for over thirty years, and also that from 1898 to 1932 the Act was amended seven times without alteration of Section 63a.

> "This is persuasive [the Court continued] that the construction adopted by the courts has been acceptable to the legislative arm of the government."

But if the courts' construction was acceptable to Congress, are we to believe that their reasoning was not? Beginning with the explicit suggestions made by Judge LOWELL in *In re Ells* just after the Act was passed, followed by those of *In re Roth & Appel* twenty-four years ago, down through the distinction between bankruptcy and equity clearly drawn by this Court in the *Filene** case, and the implications of its decision in the *Kothe*† case—all leading authorities on the subject—the reasoning of the courts has been instinct with the understanding that the provability of claims for damages under special covenants in leases depends on the terms of the particular covenant.

That is the construction of Section 63a which has been acceptable to the legislative arm of the government. And there is no evidence that a construction unfavorable to the instant covenant would be acceptable to Congress, since so far as we have been able to ascertain such a covenant has never been before the courts.

II

The inclusion of the special covenant may and does give rise to a provable claim.

The petitioner states the question as being whether a landlord and tenant can "turn an otherwise non-provable claim into a provable claim merely by stipulating" that upon bankruptcy of the tenant the lease shall *ipso*

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*Discussed in the next Point, at pp. 22-24.

†See Point III below, at pp. 27-29.

facto terminate and the tenant thereupon be liable to pay liquidated damages. Such an inquiry begs the question: the issue is whether or not the instant claim is provable. The most forcible refutation of this attempted argument, originally expressed in the Referee's decision (R. 19), is contained in the opinion of the court below, the Circuit Court of Appeals for the Second Circuit.

After discussing the common forms of covenant designed to protect the lessor in case of re-entry and pointing out that the covenant in the lease at bar avoids both the difficulties mentioned (contingency in right and in amount), the court per L. HAND, C. J., said (R. 32):

> "The argument contra may be stated as follows: If bankruptcy be an anticipatory breach, as it is, then, in a case where the lessee has promised to pay the loss, the promise or the whole series of promises, is repudiated at once. To calculate the damages, as in the case of other anticipatory breaches, the value of the consideration restored—in this case the land—will be presently estimated by the best means accessible. The result is exactly the measure to which the parties have themselves agreed in the covenant at bar. If the calculation be too contingent for a bankruptcy claim when there is no covenant, why is there* not when there is?"

The court below then went on to dispose of this point, saying (R. 33):

> "This argument loses sight of the real objection to allowing the claim when damages have not been liquidated. That is not because the rule for measuring damages is too vague or uncertain to be man-

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*So in original.

> ageable in bankruptcy; but that, though it is the best approximation available, it is still only a forecast and a forecast in these circumstances will not do for bankruptcy which is more rigid as to such issues than other proceedings, an action at law, for example. It is the uncertainty in fact of the loss that invalidates the claim; that is not remedied by an approximation which the law will accept in other connections. But when the parties have agreed that the lessee shall pay a sum to be ascertained by an accessible standard, the bankruptcy court is not liquidating a future loss at all; in its place the parties have substituted a promise, which does not look to the future, which is to pay the difference between two amounts presently ascertainable."

This reasoning of the court below, in thus disposing of petitioner's fundamental argument, is so compact that we should like briefly to point out its application to several aspects of the case and particularly to petitioner's argument thereon. It will not be amiss, also, to show how the steps in this reasoning are supported by the expressed views of this Court.

The first inquiry is whether, as a general principle and apart from the statutory requirements of bankruptcy, the inclusion of an express covenant in a lease may give rise to a provable claim for damages, notwithstanding that without such a covenant the landlord would not be permitted to prove a claim even though his actual loss were just as great. *Gardiner* v. *William S. Butler & Co., Inc., supra,* is direct authority for the answer that such a result *is* achieved by the inclusion of an express covenant.

That case involved the provability in an equity receivership of two claims filed by landlords. One claim

was under a lease providing that in case of re-entry the lessee should pay to the lessor the difference between the rental value and the rent and other payments required for the residue of the term. The other claim was for similar damages, but simply on the ground that the landlord had lost the benefit of his bargain, the lease not containing any clause stipulating for such an allowance. The lower courts had disallowed both claims. This Court allowed the claim under the lease which contained the express covenant, though disallowing the claim under the lease which contained none. The case thus holds that the parties may by contract confer on the landlord a right to damages enforcible in an equity receivership which he would not otherwise have, even though he suffered the same actual loss. And this enforcible right may be conferred even in a lease, though, as the Court said, "the law as to leases is not a matter of logic *in vacuo;* it is a matter of history that has not forgotten Lord Coke."

If this be true in equity, what of bankruptcy? The answer is afforded by the reasoning on which this Court reversed the court below in *William Filene's Sons Co.* v. *Weed, supra,* decided concurrently with the *Gardiner* case. In the *Filene* case the lease provided for re-entry in case of the tenant's failure to perform any covenant. Pursuant to a default in rent subsequent to the tenant's receivership, the landlord reentered. In the lease the tenant agreed, upon its termination as provided for, to pay the landlord the sum of certain discounted $20,000 per year payments and also the difference between the rental value and the rent and other payments named in the lease for the residue of the term (with

allowance for such of the first item as had been paid). The landlord's claim for these items was disallowed below, the court believing that the analogy of bankruptcy applied and that "The claim arises too late" (230 Fed. 31, 38). This Court stated that it perceived no ground that would justify the rejection of the first item of the claim, and went on to say (245 U. S. 597, 601-602):

> "Certainly the fact that the termination of the lease happened after the filing of the bill has no such effect, although the sum was not presently payable until then. When a statutory system is administered the only question for the courts is what the statutes prescribe. But when the courts without statute take possession of all the assets of a corporation under a bill like the present and so make it impossible to collect debts except from the court's hands, they have no warrant for excluding creditors, or for introducing supposed equities other than those determined by the contracts that the debtor was content to make and the creditors to accept. In order to make a distribution possible they must of necessity limit the time for the proof of claims. But they have no authority to give to the filing of the bill the effect of the filing of a petition in bankruptcy so as to exclude any previously made and lawful claim that matures within a reasonable time before distribution can be made."

The Court accordingly reversed the decree and allowed both the first item of the claim, and the second—"This also was contracted for and we see no reason why it should not be paid."

Quite obviously a like result would not have been achieved in bankruptcy, because "The claim arises too

late." That was the defect which would have excluded such a claim under the statutory system. The petitioner unwittingly so concedes in referring, at page 18 of its brief, to the otherwise forgotten second part of the *Manhattan Properties* decision where "this Court excluded claims based upon covenants for indemnification effective only after the date of the filing of the petition in bankruptcy." Having thus labored to establish the conclusion that the result of the *Filene* case would not have been achieved in bankruptcy, petitioner abandons further analysis of that opinion. And quite naturally, as there is no way of escaping its necessary implication that if, as here, the claim had arisen and become effective at the time of petition filed, it would have been provable in bankruptcy.

Next comes the aspect of the matter which most concerned the court below: Granting that by virtue of an *ipso facto* clause, or (as the court suggested) the doctrine of anticipatory breach, a claim would be provable if not otherwise objectionable, and recognizing that in a case where the lessee has promised to pay the loss the damages consequent on such a breach would be calculated by exactly the measure to which the parties have agreed in the covenant at bar, then "If the calculation be too contingent for a bankruptcy claim when there is no covenant, why is it not when there is?"

For answer we may again turn to petitioner's brief. "In bankruptcy the distinction has to do with the *subject matter*" (p. 19) and "It is, however, the nature of the claim * * * that conditions its provability in bankruptcy" (p. 20, quoting *Watson* v. *Merrill,* 136 Fed. 359). What is the nature, the subject matter of the

instant claim? The claim is not for such actual future loss as may or may not occur, requiring an approximation or liquidation unacceptable to bankruptcy; but

> "in its place the parties have substituted a promise, which does not look to the future, which is to pay the difference between two amounts presently ascertainable" (R. 33).

If the nature of the claim is a promise to pay damages, its provability in bankruptcy should be judged by the tests applicable to promises to pay damages. These, we have seen, are met: the claim is upon an immediate right to immediate damages.

Nor will it avail to urge that for "historical" reasons the words of the promise do not mean what they say, or should be construed to mean something quite different, or should be rejected as private attempts to rewrite the Bankruptcy Act. In the *Filene* case an express promise to pay damages was enforced as such and in strict accordance with its terms. In discussing the second item of the landlord's claim (the difference between the rental value at the date of entry and the rent reserved), this Court said:

> "The contract was not that all the rent for the term should become presently due, it was not for rent at all, but was a personal covenant that liquidated the damages upon a footing that was familiar and fair."

In *Kothe* v. *R. C. Taylor Trust, supra,* the *ipso facto* clause giving rise to damages was identical with that in the instant case, but the damages stipulated were

"an amount equal to the amount of the rent reserved in this lease for the residue of the term hereof." This Court disallowed the landlord's claim in bankruptcy on the sole ground that the provision was for an unenforceable penalty. The entire discussion turned upon liquidated damages, even though the measure agreed on was the full amount of the rent reserved. If this Court had thought the claim one for future rent and the covenant a subterfuge for amending the Bankruptcy Act by contract, that would have furnished a short way of disposing of the case. But the Court did not adopt it.

III

The damage covenant in the lease is fair, and does not sound as a penalty whether or not the damages are discounted as directed by the court below.

The damage covenant in the lease is fair,—

To appraise the fairness of the covenant, let us see what result will follow if this Court affirms the judgment below.

At the hearing before the Referee, on the order to show cause why the respondent's claim should not be disallowed and rejected, it was stipulated that "in case the Referee shall find that the claim is a provable claim, the question of the amount at which it shall be allowed is reserved and the parties may thereafter offer testimony liquidating the amount, if any" (R. 13). In reversing the order of the District Court, the Circuit Court of Appeals remanded the claim for liquidation in accordance with its own opinion (R. 34).

If, then, this Court affirms the judgment below the claim will be remanded for liquidation. Evidence will presumably be offered as to the fair rental value of the premises for the residue of the term, and such determined. The computation will then be made, as directed by the court below, of "the sum of the discounted series of installments, each made up of the rent reserved, less the fair rental value for that period."

In affirming the judgment below this Court will not be allowing the respondent's claim at any particular amount (nor indeed at any amount at all, as the fair rental value may be found to equal or exceed the rent reserved), but will only be affording the respondent an opportunity to prove in the bankruptcy such damages as respondent may actually be able to establish under the covenant in the lease. If, as the result of the testimony and computation, the respondent is unable to establish any such damages, no claim against the bankrupt estate will result. The evidence may be inadequate to establish respondent's right to damages in whole or in part. That will be a matter for decision by the court when the proofs are offered. If damages are so established and a claim is allowed in some amount, it will be because it has been judicially determined that respondent has suffered a loss under the terms of its bargain.

—and does not sound as a penalty—

If the covenant is fair from the standpoint of practical operation, may it yet be invalid for legal reasons? The petitioner, as well as the court below, has expressed the view that the determination of this question is governed by *Kothe* v. *R. C. Taylor Trust, supra;* we are quite con-

tent to accept that case as laying down the applicable test. There the lease provided that upon the filing of a petition in bankruptcy the lease should *ipso facto* and without entry terminate, and that the landlord should forthwith "be entitled to recover damages for such breach in an amount equal to the amount of the rent reserved in this lease for the residue of the term hereof." The lease was for a term of two years, and at the time of the bankruptcy had fifteen months to run. The landlord filed a claim for an amount equalling the rent for the balance of the term, which the Circuit Court of Appeals for the First Circuit allowed.

In considering the question this Court began by referring to its previous decisions* to the effect that when the intention of the parties in contracts for liquidated damages is ascertained it is ordinarily the duty of the court to carry it out, and that such contracts when reasonable in their character are not to be regarded as penalties and may be enforced between the parties. The Court continued (280 U. S. 224, 226):

> "But agreements to pay fixed sums plainly without reasonable relation to any probable damage which may follow a breach will not be enforced. This circumstance tends to negative any notion that the parties really meant to provide a measure of compensation—'to treat the sum named as estimated and ascertained damages.'
>
> Here, we find the lessee in a lease for two years agreeing that the mere filing of a petition in bank-

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**Sun Printing & Publishing Ass'n* v. *Moore*, 183 U. S. 642; *U. S.* v. *Bethlehem Steel Co.*, 205 U. S. 105, 119; *U. S.* v. *United Engineering Co.*, 234 U. S. 236, 241.

> ruptcy against him shall be deemed a breach and thereupon, *ipso facto,* it shall be terminated and the lessor shall become entitled to re-enter, also to recover damages equal to the full amount of the rent reserved for the remainder of the term. The amount thus stipulated is so disproportionate to any damage reasonably to be anticipated in the circumstances disclosed that we must hold the provision is for an unenforceable penalty."

In concluding, the Court said (p. 227):

> "Considering the time which the lease here involved had to run, nothing else appearing, it seems plain enough that the real design of the challenged provision was to insure to the lessor preferential treatment in the event of bankruptcy. The record discloses no circumstance sufficient to support a contrary view. If the term were much shorter, or there were facts tending to disclose a proper purpose, the argument in favor of the lessor would be more persuasive."

The Court thus expressly indicated that not every claim for damages based on an *ipso facto* clause in a lease is to be rejected in bankruptcy: the Court's objection went solely to the point that the stipulated damages were of an arbitrary amount, unrelated to any actual loss suffered. The tenant, said the Court, had little concern with the *amount* of the claim to be presented against the bankrupt estate, and the real design was to insure the landlord *preferential* treatment. The opinion seemed to assume that the parties could validly contract for some damages to become due on bankruptcy, and disallowed the claim solely because it was equal to the full amount of the rent reserved for the remainder

of the term. And even that basis might not be improper, the Court intimated, if the term were much shorter than the two years actually involved.

What then would tend to disclose a proper purpose? Clearly a provision which showed "that the parties really meant to provide a measure of compensation." And what could be a fairer measure of compensation than for the landlord to give full credit for what he receives back and to confine his claim to the difference between that value and the contracted rental?

—whether the damages are discounted as directed by the court below—

Petitioner's only objection to the measure of damages stipulated in the lease is that it contains no provision for discounting the minuend—"an amount equal to the amount of the rent reserved in this lease for the residue of the term hereof"—to its present value. Petitioner argues that in consequence the minuend sounds as a penalty (p. 35). In thus directing attention to the undiscounted minuend, petitioner avoids mentioning the fact that under the covenant neither is the subtrahend discounted. Thus, though the landlord receives credit for the face value of the installments of rent payable in the future, he is obliged to give credit for the face amount of the rental value in the future.

The court below* construed the damage clause "in accordance with its patent general purpose to give the

*Probably in keeping with the directions for discounting damages which it had given in *In re Marshall's Garage, Inc.*, 63 Fed. (2nd) 759 (C. C. A. 2nd, 1933), where the claim was upon the bankrupt's contract to purchase land six years in the future.

lessor indemnity and no more," and therefore held that "the proper measure of damage is the sum of the discounted series of installments, each made up of the rent reserved, less the fair rental value for that period." This method of discounting the remainder, in the case of each installment, of course produces the same result as discounting both the minuend and the subtrahend. Petitioner makes no claim that the damage covenant, when so construed as providing for a discount, is still invalid as a penalty, but contends that the result was one the court below was not free to reach, quoting on page 36 from *Hermitage Co.* v. *Levine,* 248 N. Y. 333, 338. The case itself is not in point, and the language quoted loses all applicability when we recall that the New York Court of Appeals adheres to the liberal doctrine of construing liquidated damage provisions (where reasonable) in accordance with the intent of the parties. *Little* v. *Banks,* 85 N. Y. 258, 266 (1881). That doctrine has been adopted and consistently followed by this Court, and its decisions thereon were expressly the basis on which the court below felt free to reach the result in question.* Petitioner ignores their effect.

Petitioner further argues that this Court did not attempt a discounting construction in the *Kothe* case. Exactly so,—for there, following this same line of authority, the Court sought to ascertain the intent of the parties and concluded therefrom that "the real design of the challenged provision was to insure to the lessor preferential

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*R. 34, citing *U. S.* v. *Bethlehem Steel Co.,* 205 U. S. 105, 119; *U. S.* v. *United Engineering Co.,* 234 U. S. 236, 241; *Wise* v. *U. S.,* 249 U. S. 361, 365, 366; *Hathaway* v. *U. S.,* 249 U. S. 460, 464.

treatment in the event of bankruptcy." In that case the patent general purpose of the covenant was not to give the landlord indemnity,—it was to give him a claim equalling his full rent, in addition to restoring to him the consideration therefor.

—or whether the damages are not so discounted.

But even if this Court should hold that the court below went beyond the permissible bounds of construction, or erred in interpreting the intent of the parties, the damages without discount would not be unenforceable as a penalty. The court below thought that an undiscounted recovery would "surely be more than compensatory", but expressly disclaimed any decision that such a conclusion would invalidate the whole clause.

The court's refusal to so decide was inevitable, in view of this Court's holding in the *Filene* case that such a covenant "liquidated the damages upon a footing that was familiar and fair." There at the time of the receivership and the subsequent re-entry by the landlord, the several terms granted by the lease had from over five to eight years to run. The master had computed the damages strictly in accordance with the covenant—by adding up the rent reserved and deducting the rental value.* The resulting dollar amount was expressly approved by this Court in concluding its opinion. The Court's failure to comment on the absence of discount is the more significant because the Court had just considered the matter in connection with the master's com-

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**William Filene's Sons Co.* v. *Weed*, October Term, 1917, No. 93, Transcript of Record, pp. 66-68.

putation of the discount under the $20,000 per year clause, where the parties had expressly provided therefor. Thus if the liquidated damages as computed by the master were mathematically more than compensatory, this Court nevertheless held them to be fair and enforceable. They fell far short of being "so disproportionate to any damage reasonably to be anticipated in the circumstances disclosed that we must hold the provision is for an unenforceable penalty", as the Court said in the *Kothe* case. And obviously a provision unenforceable as a penalty would have been just as unenforceable in equity as in bankruptcy.

The inherent fairness of the covenant in the instant case is quite overlooked by the *amici curiae* in support of petitioner, who state (pp. 14-15 of their brief) that it does not differ in substance from a covenant that upon bankruptcy of the lessee "the lessor shall have a provable claim in the amount of $177,788." Obviously a covenant in such terms would be unenforceable as a penalty: as this Court said in the *Kothe* case, "agreements to pay fixed sums plainly without reasonable relation to any probable damage which may follow a breach will not be enforced." In the present case the damages stipulated bear not only a reasonable relation to the probable damage, but an absolutely direct relation thereto.

The *amici curiae* in support of petitioner argue that if the decision below is sustained the instant covenant will appear in many leases and landlords "will absorb the major portions of bankrupt estates" (p. 15). Whether landlords who may obtain such covenants will share in any portion of their tenants' bankrupt estates will of course depend on the testimony adduced as to the losses

sustained under the covenants. The argument is fallacious in its premise—it assumes that the landlord is getting something to which he is not entitled. But if and to the extent that a landlord establishes his damages under a covenant which meets the requirements of the Bankruptcy Act, why should he not be allowed to share in the estate with the other creditors? The *amici curiae* then ask us to imagine the effect of the instant covenant in a hypothetical 999 year lease,—which we shall do, as best we can. If the witnesses were unable to satisfy the referee as to the certainty of their testimony regarding the fair rental value for any later part of the term, he would disregard their testimony and adopt the next best evidence available—the rental fixed by the parties themselves in the lease. Under the formula the remainder for those years or months would then be zero, and the landlord's claim would be confined to the years for which he could satisfy the referee of an actual difference in value. The whole argument is moot, however, as Congress has now imposed a narrow limit on all such claims.*

IV

The fair rental value for the residue of the term is readily ascertainable.

We should have supposed it obvious that the determination of the subtrahend would present no insuperable difficulty. Computation of the value of terms is every day being made in condemnation proceedings and other

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*See Point V below (pp. 37-42).

proceedings. The indicated steps may be visualized by reference to a case involving the apportionment of surplus moneys realized from the sale of mortgaged premises, *Clarkson* v. *Skidmore*, 46 N. Y. 297 (1871). In considering the amount to be awarded to the lessee of the premises the court said, at pages 302-304:

> "The lessee, as between himself and his lessor, had a right to the possession and enjoyment of the whole of the premises, during the residue of the term of his lease, being six years, subject only to the payment of the rent reserved in the lease and of the annual taxes which he had agreed to pay. * * * To the extent of the value of the rights thus vested in the lessee, the lessor had, by giving the lease, diminished the value of his own estate. * * *
>
> If the rent reserved in the lease was equal to, or more, than the annual value of the premises, then the estate of the lessee was manifestly worthless; but if, on the contrary, as appears to have been the fact, the annual value of the property was much greater than the rent reserved in the lease, the estate of the lessee was of importance, and a serious incumbrance on that of the lessor; and the lessee is entitled to receive its equivalent out of the surplus of the proceeds. * * *
>
> The value of the term must depend upon the circumstances of every individual case; the length of the term and conditions of the lease, the character of the property, its location, the readiness with which it may be let, the condition of the buildings, whether substantial and durable, or requiring frequent repairs, the uniformity of rents in the neighborhood or their fluctuating character; in short, every material consideration which would enter into the mind of a purchaser of the term, in judging

> what would be a fair price for it, and, like other ordinary questions of value, should be determined, as a matter of fact, upon the testimony of witnesses competent to speak upon the subject."

In the instant case the petitioner's objection to the subtrahend clause is based on the possibility of a month-to-month inquiry. Yet in the passage above quoted it will be observed that the court was not disturbed by the thought of an "annual value of the premises", even though the lease had six years to run. And in the instant case the task of appraisal will be simplified by the fact that the premises have been relet for a substantial portion of the bankrupt's former term.

The petitioner also asserts (p. 39) that the fair rental value in the future cannot be estimated because of the lease provisions for termination and abatement of rent. Petitioner forgets that the lease terminated with the filing of the petition in bankruptcy on September 30, 1932, and that thenceforth not a dollar of rent has been or ever will be payable. The term is gone; the fact to be ascertained is the fair rental value of the premises. The provisions mentioned are immaterial, since the bankruptcy court is not required to liquidate a future loss but to carry out the express contract for damages. Even where the contingency is certain eventually to occur as in the case of death, the possibility of its early occurrence, before the expiration date of an employment contract, does not prevent an employee from proving a claim for damages based on the breach of the contract by his employer's bankruptcy. *In re Schultz & Guthrie,* 235 Fed. 907, 908 (D. C. Mass., 1916), where there was not even an express covenant for damages.

V

The recent amendments to the Bankruptcy Act do not affect the provability of the instant claim.

On June 7 and 18, 1934, section 63 of the Bankruptcy Act was amended by adding three new subdivisions, one of which (together with the original introductory words of the section) is as follows:

> "*Debts which may be proved.* (a) Debts of the bankrupt may be proved and allowed against his estate which are * * * (7) claims for damages respecting executory contracts including future rents whether the bankrupt be an individual or a corporation, but the claim of a landlord for injury resulting from the rejection by the trustee of an unexpired lease of real estate or for damages or indemnity under a covenant contained in such lease shall in no event be allowed in an amount exceeding the rent reserved by the lease, without acceleration, for the year next succeeding the date of the surrender of the premises plus an amount equal to the unpaid rent accrued up to said date: Provided, That the court shall scrutinize the circumstances of an assignment of future rent claims and the amount of the consideration paid for such assignment in determining the amount of damages allowed assignee hereunder: Provided further, That the provisions of this clause (7) shall apply to estates, pending at the time of the enactment of this amendatory Act in which the time for filing such claims has not expired."

Petitioner and the *amici curiae* in its support base part of their argument against the provability of the instant claim on this amendment. Petitioner contends (p.

33), in referring to the words "damages * * *under a covenant contained in such lease"—

> "It must therefore have been the *thought* of Congress that claims for such damages, even though expressly covenanted for, were not theretofore provable in bankruptcy." (Italics ours.)

The *amici curiae* in support of petitioner suggest (p. 31):

> "By new amendments not applicable to this case, Congress has made the instant type of claim provable in a limited amount in future bankruptcies. Therefore, this claim could not have been provable prior to such amendments."

The amendment, under its last proviso, concededly does not apply to the instant proceedings, where the time to file claims expired March 30, 1933 (R. 1), and the only inquiry therefore is: What indication does this 1934 amendment give of the provability of the instant claim under the Act of 1898?

Ever since the passage of the Act of 1898 litigation of landlords' rights in bankruptcies had been a fruitful source of delay in winding up proceedings and of expense to bankrupt estates. The briefs in the *Manhattan Properties* case, particularly that of respondents, well indicate the vast extent of such litigation. Though the unfairness to landlords of the rigid requirements of the Act had often been recognized, it was not until the current depression that this and the foregoing considerations produced an insistent and wide-spread demand for amendment. The epidemic of chain store bankruptcies, simultaneously affecting scores of landlords throughout the country, was probably the immediate cause.

It had proved to be possible for many corporations which found their leases burdensome to pay off all ordinary creditors and the current month's rent, file a voluntary petition in bankruptcy (in a jurisdiction which followed the rule of *In re Roth & Appel*), and thereby bring about the inevitable and anticipated result that the trustee in bankruptcy would disaffirm the leases as unprofitable to the estate. Where the bankrupt was a subsidiary of a holding company, the latter could usually use its substantial inter-company claim to buy in the assets at the bankruptcy sale, thereafter turning them over to a newly organized subsidiary which could continue the business at the lower rentals then obtainable in a distress real estate market. The old subsidiary was, of course, abandoned as an empty corporate shell, and the landlord, who might have been the only one injured by its bankruptcy, would not even have standing in the proceedings to contest their *bona fides* or the validity of the parent company's claim: he was not a creditor.

Then came the *Manhattan Properties* decision, in February of 1934. It extinguished any possibility that landlords could prove claims for future rent under the Act of 1898 as it stood. The Court indicated that by an appropriate covenant like that now at bar a landlord could protect himself, but this of course was no solace to the thousands of landlords who held existing leases containing no such covenant, nor to those future landlords who might not be able to obtain such a covenant from their tenants.

Four months later Congress acted.

To meet such a situation the 1934 amendment embodied two clauses of prime importance. The first was a per-

missive clause which added to the debts of the bankrupt which may be proved and allowed against his estate—

> "claims for damages respecting executory contracts including future rents whether the bankrupt be an individual or a corporation,"

The second was a clause restricting the amount allowable on claims under leases, *viz.*:

> "but the claim of a landlord for injury resulting from the rejection by the trustee of an unexpired lease of real estate or for damages or indemnity under a covenant contained in such a lease shall in no event be allowed in an amount exceeding the rent reserved by the lease, without acceleration, for the year next succeeding the date of the surrender of the premises plus an amount equal to the unpaid rent accrued up to said date:"

In so enacting Congress was not concerned with niceties of expression, but was seeking at one stroke to sweep away the many vexed problems of bankruptcy as affecting leases: Litigation would be minimized, landlords would be given some compensation for their loss, and for limiting such compensation a simple rule of thumb was provided. Such an intent was commendable and thoroughly consistent with the practical condition which called forth the amendment. If the courts can see their way reasonably clear to giving effect to such an intent, surely it will be to the best interests of all concerned.

Unfortunately the amendment in its two prime provisions is anything but clear. As the *amici curiae* in support of petitioner say, the language lacks definiteness, it is difficult if not impossible to parse, and parts (if not

most) of it are inartistic and awkward. And the committee reports and amendments on the floor scarcely serve to clarify the situation. An enactment of that type requires some construction by the courts, and the best practical construction to adopt is the one which will minimize uncertainty and future disputes and will give the fullest effect to the wise purpose of the amendment, namely: that all claims of landlords under leases are to be provable (subject to the restriction on amount), whether the leases contain special covenants for damages or not.

If we are correct in believing that Congress desired *all* such claims to be provable, and in believing that the courts should so hold, then plainly no inference can be drawn as to what *particular* claims Congress thought were or were not already provable. To such considerations Congress was indifferent. If the language used perchance included a type of claim which might or might not be already provable (the instant type having never been passed on by the courts), what harm could be done thereby? Congress was thinking only of the result, and was concerned only with laying down a general rule to cover all the varied cases which might arise in the future.

Manifestly in such circumstances the recent amendment throws no light—either one way or the other—on what Congress thought the existing law was as to claims under particular covenants; and it can therefore have no bearing whatever on the provability of the instant claim.

If we are wrong, however, in following more the spirit of the amendment than its language, we cannot see that

the result as to the instant case will be affected. If the differences between the language of the permissive clause and that of the restrictive clause are found so striking as to require a different construction (as they are by the *amici curiae* in support of respondent), it must be observed that the prime difference lies in the inclusion in the restrictive clause of a phrase describing a second class of claims, not mentioned in the narrower permissive clause. And, as the *amici curiae* in support of petitioner well say thereof (p. 29):

> "The phrase 'claim of a landlord * * * for damages * * * under a covenant contained in such a lease' is a perfect description of this claim and was intended as such."

If a perfect description of the instant claim appears in this additional language of the broader clause and not in the narrower clause, is it not reasonable to believe that the claim is one of those intended to be covered by the restriction and thought not covered by the permission?

Incidentally, the above characterization of the instant claim as being within the restriction amply answers the fear expressed on page 16 of the same brief that if this Court sustains the decision below "even the limitation of rent claims to one year of rent in the new clause (7) of Section 63a will be of no avail."

Inferences drawn from subsequent statutes are at most but evidentiary in aiding the court to discharge its exclusive function of determining the meaning of a previous law, and in the present case to attach persuasive retrospective significance to an amendment so inconsistent and indefinite in its terms would be unprecedented.

VI

The decision of the Circuit Court of Appeals for the Second Circuit, remanding the claim for liquidation in accordance with its opinion, should be affirmed.

Respectfully submitted,

ALBERT STICKNEY,
HERSEY EGGINTON,
THOMAS F. DOUGHERTY,
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CHARLES ELMO

IN THE

Supreme Court of the United States

OCTOBER TERM 1933

No. [redacted] 22

IRVING TRUST COMPANY, as Trustee in Bankruptcy of OUTFITTERS OPERATING REALTY CO., INC., a Delaware corporation,

Petitioner,

against

A. W. PERRY, INC., a Massachusetts corporation,

Respondent.

MOTION AND BRIEF OF AMICI CURIAE IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

WALTER E. HOPE,
H. STRUVE HENSEL,
Amici Curiae.

IN THE

Supreme Court of the United States

OCTOBER TERM 1933

IRVING TRUST COMPANY, as Trustee in Bankruptcy of OUTFITTERS OPERATING REALTY CO., INC., a Delaware corporation, *Petitioner,* *against* A. W. PERRY, INC., a Massachusetts corporation, *Respondent.*	No. 969.

MOTION FOR LEAVE TO FILE BRIEF AS AMICI CURIAE IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

Now come Walter E. Hope and H. Struve Hensel of 15 Broad Street, New York City, and move this Honorable Court for leave to file the annexed brief as *amici curiae* in support of the petition for writ of certiorari herein, the consent of counsel for the petitioner and of counsel for the respondent having been first obtained.

The undersigned ask this leave as counsel for Roy A. Heymann, Chandler Hovey and Thomas H. McInnerney, as Trustees in Bankruptcy of Louis K. Liggett Company appointed pursuant to an order of the United States District Court for the Southern District of New York in bankruptcy proceedings entitled "In the Matter of Louis

K. Liggett Company, Bankrupt—In Bankruptcy No. 56900", in which proceedings a number of claims are at issue involving large sums of money, which claims will be determined or at least materially affected by the outcome in the present cause.

WALTER E. HOPE,
H. STRUVE HENSEL,
Office and Post Office Address:
15 Broad Street,
New York, New York.

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IN THE

Supreme Court of the United States

OCTOBER TERM 1933

IRVING TRUST COMPANY, as Trustee in Bankruptcy of OUTFITTERS OPERATING REALTY CO., INC., a Delaware corporation, *Petitioner,* *against* A. W. PERRY, INC., a Massachusetts corporation, *Respondent.*	No. 969.

BRIEF OF AMICI CURIAE IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

Statement by Counsel

This brief is submitted on behalf of Roy A. Heymann, Chandler Hovey and Thomas H. McInnerney as Trustees in Bankruptcy of Louis K. Liggett Company, appointed by the United States District Court for the Southern District of New York in a proceeding entitled "In the Matter of Louis K. Liggett Company, Bankrupt —In Bankruptcy No. 56900". In that proceeding there are now pending four cases in the United States District

Court for the Southern District of New York and in the Circuit Court of Appeals for the Second Circuit in which are involved lease clauses almost identical with the lease clause here involved, and which claims aggregate $399,765.34. There are also involved before the United States District Court for the Southern District of New York disputed claims aggregating $334,319.12, the determination of which claims involve consideration and application of the principles announced by the United States Circuit Court of Appeals for the Second Circuit in the instant case. Dividends upon such claims, if allowed, will clearly exceed 50% thereof (*i.e.*, $367,042.23) and probably 80% thereof (*i.e.*, $587,265.57). All of such claims have been objected to by the aforenamed Trustees in Bankruptcy and are now in litigation.

Statement of Opinions Below, Facts, Jurisdiction, Specification of Errors and Statute Involved

The opinions below, facts, jurisdiction of this Court, the statute involved and the errors committed by the United States Circuit Court of Appeals for the Second Circuit have been fully referred to and set forth in the petition for writ of certiorari and brief in support thereof filed herein by the petitioner.

Summary of Argument

Point I

The decision of the Circuit Court of Appeals for the Second Circuit in this case is contrary to, and does not correctly interpret, the decision of this Court in the case of *Manhattan Properties, Inc.* v. *Irving Trust Company,* 54 Sup. Ct. Rep. 385.

Point II

Parties to a lease cannot stipulate what claims, if any, are provable in bankruptcy.

Point III

The case is of utmost importance in that the clause construed is now in general use and, if the instant case is not reversed, will become uniform in all leases drawn for corporate tenants.

Point IV

The Circuit Court of Appeals for the Second Circuit has practically invited review of its decision in this case and, it is believed, expressed great doubt as to the correctness thereof.

ARGUMENT

I

The Decision of the Circuit Court of Appeals for the Second Circuit in this Case Conflicts with the Decision of this Court in *Manhattan Properties, Inc.* v. *Irving Trust Company*.

The undersigned, as counsel for the Trustees in Bankruptcy of Louis K. Liggett Company, in view of the size of such estate (over $7,000,000) and the large sums involved in the final determination of this case, feel constrained to add their plea to that of the petitioner for the granting of a writ of certiorari. It is also the belief of the undersigned that the practical consequences of the decision below are even more serious and threatening to the proper administration of estates in bankruptcy than is indicated in the petition and the brief of petitioner. In other words, it is believed that the necessity and importance of reversing the decision below have been, if anything, understated rather than overstated by petitioner.

The undersigned believe that the decision below is, as a practical matter, more than an exception to the decision of this Court in the case of *Manhattan Properties, Inc.* v. *Irving Trust Company*, 54 Sup. Ct. Rep. 385 and that the principles upon which the decision below is based are contrary to, and an erroneous interpretation of, the aforesaid decision of this Court.

Although it was clear that this Court in the *Manhattan Properties* decision definitely stated that future

rent claims were not provable under the Bankruptcy Act and could not be made so provable by stipulation of the parties or otherwise, except by an actual legislative amendment, this decision endeavors to limit the *Manhattan Properties* decision solely to covenants of indemnity and leases devoid of bankruptcy clauses. The following definite pronouncements of this Court were wholly ignored:

> "The courts uniformly held (under Act of 1867) that claims for future rent or *for damages for breach of covenant to pay rent,* were not provable under the act, though differing as to the reason; some holding them not contingent claims within the statutory definition, and others thinking the express permission of proof for rent past due at the date of bankruptcy impliedly excluded claims for rent thereafter falling due. * * *
>
> In view of the extended consideration and discussion which preceded the passage of the Act (of 1898), the failure to include a provision for claims for loss of rent or *for damages consequent on the abrogation of leases,* is significant of an intent not to depart from the precedents disallowing them." (Italics and parenthetical references ours.)

II

The Prohibition of the Bankruptcy Act against the Provability of Future Rent Claims Cannot be Avoided by Stipulation of the Parties to a Lease.

A fundamental question of law is here involved and must be definitely decided, *i.e.,* can the parties to a lease

stipulate as to what claims, if any, are provable in bankruptcy or is the intent of Congress, as expressed in the statutes and construed by this Court in the *Manhattan Properties* decision, to remain supreme?

Unless this decision is now reversed, the next step is obvious. Stripped of its legalistic verbiage and framework, the lease provision here involved is merely an agreement between the parties, contrary to the provisions of the Bankruptcy Act, giving the landlord a provable claim. This conclusion is not merely the conclusion of the undersigned but is the precise interpretation of the decision below made by two of the claimants referred to above in the Louis K. Liggett Company bankruptcy proceedings in a brief filed with the United States District Court for the Southern District of New York, in which the following statement is made with respect to the instant case:

> "it shows that by a proper clause in the lease rental or damages, not otherwise provable in bankruptcy, may become provable."

Unless undue attention is to be paid to form, leases and contracts of the future need only provide:

> "In the event of bankruptcy of either party, this lease (or contract) shall *ipso facto* terminate and the other party shall have a provable claim in bankruptcy in the amount of $."

If the sum fixed is not a penalty or unduly excessive, the claim fixed by stipulation must under the theory of the decision below be approved and allowed. Under such determination, Section 63 of the Bankruptcy Act will be

practically nullified and claims can and will be made provable without legislative action.

If such principle be established, there seems no reason why the corollary should not also be true, *i.e.,* parties can stipulate as to what claims will be not provable in bankruptcy and, therefore, not dischargeable. Obviously, such result cannot be permitted and the decision below must be reviewed and reversed.

III

This Case is of Great Public Importance.

The clause construed below is now in general use and, if the instant case is not reversed, will become uniform in all leases drawn for corporate tenants. Landlords will be insistent upon such form, particularly in the case of long term leases at high rentals. Since the claims will be payable only in the event of bankruptcy, the tenant will know that he will never have to bear the burden of the promise, will have little concern as to the interests of other creditors and will be enabled to favor particular creditors (see *Kothe* v. *Taylor Trust,* 280 U. S. 224, 226).

Furthermore, the clarification of the law effected by this Court in the *Manhattan Properties* case will be voided and costly litigation induced and invited.

IV

A Review of this Decision has been Practically Invited by the Circuit Court of Appeals for the Second Circuit.

It is believed that the Circuit Court of Appeals for the Second Circuit has expressed doubt as to the correctness of this decision and practically invited review thereof. In the case of *Wright* v. *Irving Trust Company, Trustee,* decided by the Circuit Court of Appeals for the Second Circuit on April 2, 1934 (opinion by Learned Hand, *C.J.*) such Court said:

> "In *In Re Roth & Appel,* 181 Fed. Rep. 667, we expunged a claim for rent because Section 63 (a) of the Bankruptcy Act forbad all contingent claims. That construction was repudiated in *Maynard* v. *Elliott,* 283 U. S. 273, and was not revived in *Manhattan Properties* v. *Irving Trust Co., supra.* As we understand it, the invalidity of rent claims is not deduced from the statute, but is a historical exception; the earlier acts by judicial construction had refused to allow claims for future rents, even when contingent claims were provable; although such claims are now generally provable, not only did Congress fail to include rents in 1898, but it continued inert through many amendments, in spite of a number of decisions in accord with the earlier interpretation. It is not altogether plain how we ought to circumscribe such a doctrine; how far it should be limited to the occasions which have heretofore arisen; how far we should rationalize it in the interest of convenience in application. However, we have twice already

> held that provable claims may arise under leases, if the obligation be certain in both event and amount at petition filed. *A. W. Perry Inc.* v. *Irving Trust Co.*, 69 Fed. (2) ; *Winston Salem Temple* v. *Irving Trust Co.*, 69 Fed. (2) . *Part of the discussion in Manhattan Properties Inc.* v. *Irving Trust Co., supra,* (290 U. S.), *certainly gives color to that notion, and we shall take it as the proper test, until the Supreme Court decides otherwise."* (Italics ours.)

It will be noted that the interpretation of the *Manhattan Properties* decision, as expressed in the foregoing quotation from the *Wright* case, is quite different from the interpretation expressed in the instant decision but that, having made the decision in the instant case, the Circuit Court of Appeals for the Second Circuit is now awaiting the review and final determination of this case before correcting, modifying or changing the rules previously announced.

V

A Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit Should Be Granted in this Case.

Respectfully submitted,

WALTER E. HOPE,
H. STRUVE HENSEL,
Amici Curiae,
15 Broad Street,
New York, New York.

The undersigned, counsel for the petitioner and counsel for the respondent, hereby acknowledge service of, and consent to the filing of, the foregoing brief by Walter E. Hope and H. Struve Hensel, as *amici curiae*.

CHARLES K. BEEKMAN

EDWARD K. HANLON

Counsel for Irving Trust Company, as Trustee in Bankruptcy of Outfitters Operating Realty Co., Inc., a Delaware corporation, Petitioner.

JOHN M. PERRY

Counsel for A. W. Perry, Inc., a Massachusetts corporation, Respondent.

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FILED
SEP 24
CHARLES ELMORE

IN THE

Supreme Court of the United States

OCTOBER TERM 1934

No. 22

IRVING TRUST COMPANY, as Trustee in Bankruptcy of Outfitters Operating Realty Co., Inc.,

Petitioner,

against

A. W. PERRY, INC.,

Respondent.

MOTION AND BRIEF OF AMICI CURIAE IN SUPPORT OF PETITIONER UPON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

WALTER E. HOPE,
H. STRUVE HENSEL,
Amici Curiae.

Supreme Court of the United States

OCTOBER TERM 1934

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IRVING TRUST COMPANY, as Trustee in Bankruptcy of Outfitters Operating Realty Co., Inc.,

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MOTION FOR LEAVE TO FILE BRIEF AS AMICI CURIAE IN SUPPORT OF PETITIONER

Now come Walter E. Hope and H. Struve Hensel of 15 Broad Street, New York City, and move this Honorable Court for leave to file the annexed brief as *amici curiae* in support of petitioner, the consent of counsel for petitioner and of counsel for respondent having been first obtained.

The undersigned ask this leave as counsel for Roy A. Heymann, Chandler Hovey and Thomas H. McInnerney, as Trustees in Bankruptcy of Louis K. Liggett Company, appointed pursuant to an order of the United States District Court for the Southern District of New York in bankruptcy proceedings entitled "In the Matter of Louis K.

Liggett Company, Bankrupt—In Bankruptcy No. 56900." In that proceeding there were filed four claims, aggregating $399,765.34, which are based upon lease clauses almost identical with the lease clause here involved. All of such claims were objected to by the Trustees in Bankruptcy of Louis K. Liggett Company and litigation in respect thereof has been commenced and will be re-opened or is now pending in the United States District Court for the Southern District of New York and in the Circuit Court of Appeals for the Second Circuit. Furthermore, pursuant to an agreement of compromise and settlement, confirmed by the United States District Court for the Southern District of New York after a special meeting of all creditors, there is now reserved and will be paid, if such claims are held provable in the amounts filed, a dividend of 85% or $339,800.54. These four disputed claims aggregate almost as much as all other claims allowed to landlords, approximately 345 landlords having proved general claims aggregating $458,-870.02.

There are two additional disputed claims aggregating $282,902.59, the determination of which claims involves the validity of certain acceleration of rent clauses which, it has been contended by claimants, are provable in accordance with the principles announced by the United States Circuit Court of Appeals for the Second Circuit in the instant case. Dividends are now reserved upon such claims in the amount of $250,527.88 (more than 85% inasmuch as part of such claims are alleged to be preferred). Such claims have been held to be not provable by the Referee in Bankruptcy but a petition has been filed for the review of such decision and order by the United States District Court for the Southern District of New York.

Practically all other disputed claims in the Louis K. Liggett Company bankruptcy have been finally determined and the ultimate liquidation of that estate is dependent largely upon the decision of this Court in the instant case.

New York, N. Y., September 15, 1934.

WALTER E. HOPE,
H. STRUVE HENSEL,
Office and Post Office Address:
15 Broad Street,
New York, New York.

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Supreme Court of the United States

OCTOBER TERM 1934

No. 22

IRVING TRUST COMPANY, as Trustee in Bankruptcy of Outfitters Operating Realty Co., Inc.,

Petitioner,

against

A. W. PERRY, INC.,

Respondent.

ON WRIT OF CERTIORARI TO UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF OF WALTER E. HOPE AND H. STRUVE HENSEL, AS AMICI CURIAE IN SUPPORT OF PETITIONER

Opinions Below

Neither the opinion of the Referee (R. 13-23) nor the opinion of the District Court (R. 26) is reported in the Federal Reporter or Federal Supplement. The opinion of the United States Circuit Court of Appeals is reported in 69 Fed. (2nd) 90.

Statutes Involved

Section 63 of the Bankruptcy Act, as applicable to this case, provides*:

> "*Debts Which May Be Proved.*—a. Debts of the bankrupt may be proved and allowed against his estate which are (1) a fixed liability, as evidenced by a judgment or an instrument in writing, absolutely owing at the time of the filing of the petition against him, whether then payable or not, with any interest thereon which would have been recoverable at that date or with a rebate of interest upon such as were not then payable and did not bear interest; (2) due as costs taxable against an involuntary bankrupt who was at the time of the filing of the petition against him plaintiff in a cause of action which would pass to the trustee and which the trustee declines to prosecute after notice; (3) founded upon a claim for taxable costs incurred in good faith by a creditor before the filing of the petition in an action to recover a provable debt; (4) founded upon an open account, or upon a contract express or implied; and (5) founded upon provable debts reduced to judgments after the filing of the petition and before the consideration of the bankrupt's application for a discharge, less costs incurred and interest accrued after the filing of the petition and up to the time of the entry of such judgments.
>
> b. Unliquidated claims against the bankrupt may, pursuant to application to the court, be liquidated in such manner as it shall direct, and may thereafter be proved and allowed against his estate."

*See Appendix A for amendments of June 7 and 18, 1934, which are not here applicable except to disclose the intent of Congress that the instant type of claim was not provable prior to the enactment thereof, as explained *infra*, pp. 26 to 37.

Section 1 (11) provides:

> " 'debt' shall include any debt, demand, or claim provable in bankruptcy;"

Section 17 provides:

> "A discharge in bankruptcy shall release a bankrupt from all of his provable debts," * * *

with exceptions not here material. (Act of July 1, 1898, Sections 1, 17 and 63, 30 Stat. 562, as amended; U. S. C. A., Title 11, Sections 1, 35 and 103.)

Statement

On September 30, 1932 Outfitters Operating Realty Co., Inc. (formerly known as Lerner Stores Corp., a Delaware corporation) was adjudicated a bankrupt upon its voluntary petition in the United States District Court for the Southern District of New York (R. 1).

On March 29, 1933 A. W. Perry, Inc., the claimant-respondent herein, as lessor of certain premises located at 459 Washington Street, Boston, Massachusetts, filed a proof of claim in the sum of $177,788 alleged to be for "Damages for breach of covenant to pay rent under a lease" (R. 5) dated January 28, 1929 leasing said premises to the bankrupt for a term of fifteen years and ten months from March 1, 1929 (*i.e.*, until December 31, 1944) at an annual rental graduated upward over the term of the lease from $35,000 for the first ten months to $39,805 for the last five years, plus certain taxes and other charges (R. 6-7). *Inter alia,* the lease contained the following covenant (R. 10):

> "and, for the more effectual securing to the Lessor of the rent and other payments herein provided, it is agreed as a further condition of this lease that the filing of any petition in bankruptcy or insolvency by or against the Lessee shall be deemed to constitute a breach of this lease, and thereupon, *ipso facto* and without entry or other action by the Lessor, this lease shall become and be terminated; and, notwithstanding any other provisions of this lease, the Lessor shall forthwith upon such termination be entitled to recover damages for such breach in an amount equal to the amount of the rent reserved in this lease for the residue of the term hereof less the fair rental value of the premises for the residue of said term."

Nothing appears in the proof of claim or in the record indicating how the damages in the amount of $177,788 were calculated.

On April 5, 1933 the Trustee in Bankruptcy obtained an order to show cause why the claim should not be disallowed and expunged (R. 3-4). At the hearing on such order to show cause, it was stipulated that all questions as to the amount of the claim, if provable, were reserved until after final determination of its provability (R. 13). The Referee disallowed the claim in its entirety, holding that, as a matter of law, the alleged damages were not provable, and entered an order expunging the proof of claim (R. 13-23).

Upon petition for review the order of the Referee was affirmed by the District Court (R. 26) upon the authority of the then unreported decisions of the Circuit Court of Appeals for the Second Circuit in *Brown* v. *Irving Trust Company* and *Manhattan Properties, Inc.* v. *Irving Trust*

Company (1933), 66 Fed. (2nd) 470, affirmed by this Court, (1934) 291 U. S. 320. Upon appeal, the judgment below was reversed and the proof of claim was remanded for liquidation, the damages declared to be the sum of the discounted series of instalments, each made up of the rent reserved less the fair rental value for that period (R. 31-35). This measure of damages was not precisely the measure provided in the lease covenant quoted above but a modification thereof deemed necessary by the Court to save the covenant from the prohibition of *Kothe* v. *Taylor Trust,* (1930) 280 U. S. 224 (R. 33).

The reversal of the decisions of the Referee and the District Court was explained by the Circuit Court of Appeals as necessary in view of the language of the above quoted covenant in the lease. It was held by such Court that the decision in *Manhattan Properties, Inc.* v. *Irving Trust Company,* (1934) 291 U. S. 320, left the door open for proving claims for damages for loss of future rent provided the correct clause or covenant was used (R. 32). The above quoted covenant (after modification of the provision as to the quantum of damages) was held sufficient because (a) the lease was terminated and the claim created *ipso facto* upon the filing of the petition in bankruptcy and (b) the modified measure of damages did not seem unreasonable (R. 32-33).

A writ of certiorari from this Court was applied for on the ground that such decision was a misinterpretation of the *Manhattan Properties* decision and, in fact, contrary thereto. The writ of certiorari was granted by this Court on May 14, 1934.

Summary of Argument

I

IT APPEARS ON THE FACE OF THE INSTANT CLAIM THAT IT IS NOT PROVABLE UNDER THE DECISION OF THIS COURT IN *Manhattan Properties, Inc.* v. *Irving Trust Company.*

The proof of claim admits on its face that it is for "Damages for breach of covenant to pay rent under a lease" (R. 5), which is the identical language used by this Court in *Manhattan Properties, Inc.* v. *Irving Trust Company, supra,* 333-334, 335*, in describing the category of unprovable real estate claims. Before this claim can be allowed, the *Manhattan Properties* case must be reversed and the language used by this Court therein must be substantially modified.

II

THE INSTANT CLAIM CANNOT BE MADE PROVABLE, CONTRARY TO THE BANKRUPTCY ACT, BY AN AGREEMENT BETWEEN CLAIMANT AND THE BANKRUPT.

Congress has prescribed the various classes of provable claims according to the substance and inherent nature of the claims involved. Parties to a lease cannot escape the effect of such prescription by agreeing as to what claims are provable and what are not provable.

---

*Unless otherwise indicated, all references to the *Manhattan Properties* case refer to the decision of this Court reported in 291 U. S. 320.

Stripped of its legalistic verbiage, this instant covenant is merely an agreement that, in spite of the statute, a claim for damages for loss of future rent shall be provable. If the instant claim is sustained, all types of claims can be made provable (or not provable if desired) by mere agreement and irrespective of the statute.

III

The Intent of Congress to Exclude the Instant Claim from the Category of Provable Claims Is Clear and Has Been Recognized by This Court.

Such intent was clear before the 1934 amendments to the Bankruptcy Act as demonstrated by the historical review of the intent of Congress as made in *Manhattan Properties, Inc.* v. *Irving Trust Company, supra,* 332-337.

Inasmuch as the 1934 amendments [new clause (7)] to Section 63a of the Bankruptcy Act now make the instant claim provable in future bankruptcies in a limited amount (not more than rent for one year after the date of surrender), such type of claim could not have been intended to be provable prior to the enactment of such 1934 amendments and, therefore, not in this case.

Such conclusion is clear and is important not only in respect of this claim but in respect of future bankruptcies. If the instant claim is not expunged, it will have been construed as outside the scope of new clause (7) of Section 63a and, therefore, all landlords using the mystical language here used will prove their claims in full. The intent of Congress to limit such claims in the future to a comparatively small amount will thus be evaded.

ARGUMENT

I

It appears on the face of the instant proof of claim that it is not provable under the decision of this Court in *Manhattan Properties, Inc.* v. *Irving Trust Company*.

The proof of claim on its face frankly admits that the $177,788 claimed is for:

> "Damages for breach of covenant to pay rent under a lease." (R. 5)

In other words, claimant itself, in precise language of its own selection, has identified its claim with the very type of claim held to be unprovable by this Court in *Manhattan Properties, Inc.* v. *Irving Trust Company* (1934), 291 U. S. 320, 333-334, 335:

> "The courts uniformly held (under Act of 1867) that claims for future rent or *for damages for breach of covenant to pay rent* were not provable under the act, though differing as to the reason; some holding them not contingent claims within the statutory definition, and others thinking the express permission of proof for rent past due at the date of bankruptcy impliedly excluded claims for rents thereafter falling due. (333-334)
>
> * * *
>
> In view of the extended consideration and discussion which preceded the passage of the Act (of 1898), the failure to include a provision for claims for loss of rent or *for damages consequent on the abrogation of leases* is significant of an intent not

to depart from the precedents disallowing them." (335) (Italics and parenthetical references ours.)

The claimant has, therefore, on the face of the claim and long before the *Manhattan Properties* decision, admitted that the instant claim is not provable under the law as announced by this Court.

This argument is not mental "sleight of hand". It is not mere coincidence that claimant in March, 1933 selected the identical language to describe its proof of claim as was used by this Court in February, 1934 to describe the type of claim which, as a matter of legislative and judicial history, has always been unprovable. Until it became desirable for claimant to avoid the effect of the *Manhattan Properties* decision, claimant as well as everyone else recognized this claim as one "for damages for breach of covenant to pay rent" or "for damages consequent on the abrogation of leases." Certainly, in view of the normal and customary meaning of words and the identity of the types of claims as a matter of fact and substance, this Court could not have used such plain and unequivocal language, if it did not intend to prohibit the provability of this claim as well as all other similar claims. Fine spun legalistic reasoning may try to avoid the normal and customary meaning of words. But it cannot be done. Claimant has itself, unwittingly perhaps but nevertheless plainly, admitted the truth.

Furthermore, if the circumstances of the *Manhattan Properties* case be reviewed, the identity of this claim as a matter of substance with those defined by this Court as unprovable is inescapable. Although the covenants involved in the *Manhattan Properties* case were covenants of indemnity, the case was presented as a test case and the issue was made as wide as possible, *i.e.*, can claims for future rent

or damages for the loss thereof as a result of an adjudication of bankruptcy be proved against the bankrupt estate of a tenant? The landlord-claimant argued that all such claims were provable since as a matter of logic they were within the scope of Section 63a(4), being based upon an express contract. The respondent-trustee in bankruptcy argued that the construction of the statute was not a matter of logical interpretation of language but involved an historical analysis of the intent of Congress. The latter proposition was accepted by this Court and all claims for damages for loss of future rent were excluded unequivocally (in the language of this Court quoted above) from the category of provable claims. Exceptions in the case of this or any other claim were not suggested.

In addition, it should be noted that, as a practical matter, the damages sought to be proved here are the same in theory and manner of calculation as those denied provability in the *Manhattan Properties* case. Both leases were drawn on the theory that landlords should somehow, contrary to the intent of Congress, be given a provable claim against the estates of bankrupt corporate tenants. In both instances the damages sought to be proved were equal to the difference between the rent stipulated in the lease for the balance of the term and the alleged fair rental value of the premises in the future—in both instances the calculation involved a forecast and guess as to probable future values which are clearly impossible of accurate determination. All other legal consequences are also identical. In both instances the leases were terminated—in the *Manhattan Properties* case by action of the landlord and in the instant case upon the filing of the bankruptcy petition as provided in the lease. In both instances the trustee in bankruptcy had a reasonable time to remove from the

premises or consummate new arrangements. The only differences are in respect of words and phrases.

It is impossible to draw any conclusion from the foregoing quotation from this Court's *Manhattan Properties* decision, except that claims such as the instant claim are not provable. If the contrary interpretation by the court below is correct, the elaborate review by this Court of the earlier acts and cases, of the development of the British Act and of the rejection of Judge Lowell's proposed statute (making these claims provable) is rendered insignificant and practically meaningless. Yet such review takes up practically the entire decision and involves the selection of a theory of interpretation of the Bankruptcy Act of 1898 diametrically opposed to the interpretation of the court below. It is not modified or contradicted by the last two paragraphs of this Court's decision which merely discussed the logical inconsistencies of one of the landlord-claimant's arguments concerning indemnity covenants.

We must repeat—it appears on the face of the claim that it is not provable. This is not because claimant is chained to the language used in describing its alleged claim so that the substance and inherent nature of the claim cannot be examined. It is rather that the identity of claimant's language in describing its claim and this Court's language in describing a category of claims not provable as a matter of history and Congressional intent admits the substance and inherent nature of the claim and makes it now impossible for claimant to assert that the prohibition of the *Manhattan Properties* decision does not refer to this claim. The instant claim cannot be provable unless the *Manhattan Properties* case is reversed and the foregoing quotation therefrom is substantially modified.

II

The instant claim cannot be made provable, contrary to the Bankruptcy Act, by an agreement between claimant and the bankrupt.

There should be no illusions concerning the purpose or intent of the covenant in this lease. It was obviously devised for one purpose, *i.e.,* to give the landlord, in the event of bankruptcy, a provable claim for damages for loss of future rent (R. 18). This is generally known and, if not now admitted by claimant, was admitted in the covenant itself by the declaration that the purpose was "for the more effectual securing to the Lessor of the rent and other payments herein provided" (R. 10). Since the clause was operative only in the event of bankruptcy, it could only confer such security by raising a provable claim. In other words, this covenant was devised to give the landlords precisely what was denied to them in *Manhattan Properties, Inc.* v. *Irving Trust Company, supra.* It had no other function. No one ever expected the tenant to pay anything under this covenant. *Kothe* v. *Taylor Trust, supra,* 226. The only obligors under this covenant, if it should be sustained, are the unconsulted and vigorously dissenting other creditors of the bankrupt.

It was known that claims for future rent or damages for the loss thereof would not ordinarily be held provable. It was reasonably clear since *In re Roth & Appel* (1910), 181 Fed. 667, that covenants of indemnity would not suffice to turn an unprovable claim into a provable one. It was known since *Kothe* v. *Taylor Trust , supra,* that *ipso facto* termination of the lease upon bankruptcy and a stipula-

tion that all rent to accrue in the future should be immediately due and owing would not avoid the exclusion of such claims from the statute. Enterprising landlords and lawyers have, therefore, been searching for many years for a magical formula or covenant. The instant one is about the only one left untried and it succeeded once in an equity receivership case, although it was there clearly recognized by this Court as insufficient in bankruptcy where a precise statute is controlling. *Filene's Sons Co.* v. *Weed,* (1918) 245 U. S. 597, 601-602. Nevertheless, since the bankruptcy statute could not (until 1934) be changed, this possibly magical covenant was worth a chance. If it did not create a provable claim, it was realized that probably nothing could, short of an amendment to the statute which was not then feasible. The bankrupt was willing to have the covenant included in the lease, as it would never have to pay anything under it.* So the covenant was tried and, strangely enough, was held to be magical by the Circuit Court of Appeals.

But the only question in the case which was apparent to the Circuit Court of Appeals was (R. 32):

> Will this clause serve to create a provable claim?

By thus phrasing the question, the Court assumed that some covenant must have the necessary magic and thus missed what should have been the main and only question:

> Is there any covenant or group of words sufficiently magical to turn an unprovable claim into a

*The question of a discharge was not important in the case of a corporate lessee. But we have never heard of the covenant being used in a lease with an individual lessee who undoubtedly would be interested in the broadest possible discharge.

> provable one and to avoid the provisions of the statute and the intent of Congress?

Had the Circuit Court of Appeals considered that question rather than the one propounded, it is believed that such Court would have arrived at the opposite result as did the Referee, who stated (R. 19):

> "Mere language should not be able to create a charge against creditors which otherwise does not exist. Merely changing the label and calling the future unaccrued rent herein immediate damages, *ipso facto,* should not bring about such an undesirable result to the serious prejudice of the other creditors herein who hold 'just demands based upon adequate consideration' as pointed out heretofore."

Obviously, if this claim is sustained, the Bankruptcy Act becomes a "game of words". This is practically admitted by respondent in its brief in opposition to the writ of certiorari (p. 5):

> "Nor does the allowance of the claim in the instant case have any far reaching consequences since the lease stands on its own footing and is not a precedent for the allowance of other claims *unless based on identical language.*" (Italics ours.)*

Under such theory, the type of claim would not be important but the words used to create or describe the claim would be controlling. Such cannot be the law.

The fallacy in the entire argument of respondent and in the decision of the Circuit Court of Appeals can be demonstrated by stripping the covenant of its legal verbiage. The covenant would then read as follows:

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*This also ignores the fact that, if this claim be sustained, ***identical language*** will become extremely popular in the future.

> "In the event of the filing of a bankruptcy petition against the lessee, the lessor shall have a provable claim in the amount of $177,788."

The impropriety and ineffectuality of such type of covenant to raise a provable claim in bankruptcy is instantly recognized. Yet, while such type of covenant may be more naive and have less legalistic flavor or magic, it does not differ in substance, purpose or desired effect from the covenant here under consideration. If the instant claim is to be recognized, the magic of the words used is magic indeed.

It is submitted that this issue must be squarely met. Is the provability of claims to be determined by the language used in the covenants alleged to create the claims? Or is the statute to define the types of provable claims? Can parties, by stipulation or agreement or by the use of specifically approved words, define what claims shall be provable? Or is the intent of Congress as expressed in the Act to determine the provability of claims?

Such questions answer themselves and were categorically answered by this Court. Unless Congress remains supreme as the arbiter of how bankrupt estates are to be distributed, the door to the granting of a type of preference to certain creditors will be thrown wide open. Parties to an agreement cannot be permitted to stipulate what claims are provable. The instant covenant and this case are already famous. If the decision below is sustained, this covenant, now appearing in many leases (particularly in New England), will appear in all leases. Landlords will absorb the major portions of bankrupt estates. Landlords will be enabled to evade the purpose of the Bankruptcy Act as defined by this Court in *Kothe* v. *Taylor Trust, supra,* 227:

> "The broad purpose of the Bankruptcy Act is to bring about an equitable distribution of the bankrupt's estate among creditors holding just demands based upon adequate consideration. Any agreement which tends to defeat the beneficent design must be regarded with disfavor."

As will be hereinafter pointed out, even the limitation of rent claims to one year of rent in the new clause (7) of Section 63a will be of no avail.

In this connection, it should be noted that this Court was unfavorably impressed by the amount of the claim in the *Kothe* case, which was only $5,000. The instant claim is $177,788. Furthermore, the *Kothe* case lease had about one and a quarter years to run while the instant lease does not expire until December 31, 1944 (R. 7), *i.e.*, thirteen years from the date of bankruptcy (R. 1). The admonition of this Court in the *Kothe* case should be remembered (p. 227):

> "If the term were much shorter, or there were facts tending to disclose a proper purpose, the argument in favor of the lessor would be more persuasive."

Yet here the term is longer and the purpose the same. Furthermore, if this claim be sustained, imagine the effect on bankrupt estates of the inclusion of these covenants in 99 and 999 year leases.

If parties can by agreement determine what claims are provable, it is only logically consistent to hold that parties can by agreement determine what claims are not provable and, therefore, not dischargeable. This is not important in the case of corporations but it is most important in the case of individuals who might, by economic necessity or otherwise, be forced to waive the benefits of

the Bankruptcy Act and agree that certain claims would be not provable or dischargeable. Such state of affairs could obviously not be permitted to arise.

The decision below must be reversed. To hold otherwise, would of necessity mean that a stipulation between the parties can change an unprovable claim into a provable one. Such effect may be denied but it is obvious upon very little reflection. The only safe rule is to follow the statute. In Section 63a of the Bankruptcy Act Congress has defined the type of provable claims and as stated by this Court (*Manhattan Properties, Inc.* v. *Irving Trust Company, supra,* 336):

> "If the rule is to be changed Congress should so declare."

III

The intent of Congress to exclude the instant claim from the category of provable claims is clear and has been recognized by this Court.

A. Such intent was clear before the 1934 amendments to the Bankruptcy Act.

This proposition should not require any argument after the *Manhattan Properties Inc.* v. *Irving Trust Company, supra,* but at the risk of some repetition, the approach of this Court to the problem presented in that case will be briefly reviewed. This Court did not proceed to construe the pertinent Section 63a by a logical analysis of the language used therein or by analogy to other types of legal relationships. Claims for future rent and damages for the loss thereof were held unprovable not because they were uncertain as to

amount or liability or contingent at the date of the filing of the petition in bankruptcy. *Claims for future rent and damages for the loss thereof were held not provable because Congress did not intend such type of claim to be provable.* As stated by this Court (*Manhattan Properties, Inc.* v. *Irving Trust Company, supra,* 332):

> "The issue is not one of power, for plainly Congress may permit such claims or exclude them. *The sole inquiry is the intent of the Act.*" (Italics ours.)

As admitted by this Court in the *Manhattan Properties* case (p. 332), so in this case, the contention of claimant-respondent may have been, prior to that case, "as a matter of logic, an admissible one." Nevertheless, the apparent logic of the argument that future rent claims should be deemed provable under Section 63a (4) was disposed of adversely to the landlords simply by an examination of the intent of Congress. In this case as in the *Manhattan Properties* case, decisions will undoubtedly be cited in support of the argument that this claim is not contingent or uncertain. The alleged significance of the device of "*ipso facto* termination" of the lease may be expounded. It may be argued, as it was by the Circuit Court of Appeals (R. 32), that the instant claim became definite as to amount and liability on the date of the filing of the petition. All such arguments in so far as there applicable were made in the *Manhattan Properties* case and overruled. They are no more applicable here. The issue cannot thus be settled. Irrespective of such considerations, we are determining the intent of Congress with respect to the provability of a type of claim, *i.e.,* for damages for loss of future rent. Such intent alone controls.

Once such controlling principle is understood, it is a simple matter to search the legislative and judicial history of our Bankruptcy Acts from 1800 to date to determine just what type of claims Congress intended to include within Section 63a and, therefore, within the scope of the discharge provided for in Sections 1 (12), 14 and 17 of the Bankruptcy Act of 1898. It is not necessary to repeat here such history up to the commencement of the year 1934. It was reviewed at length in this Court's decision in the *Manhattan Properties* case (pp. 332-337) and at even greater length in the brief for respondent in that case (pp. 12-43). The most interesting fact to note, as pointed out by this Court, is that, while the reasons given by many courts varied (some being understandable and others being rather strained and swept away in other cases), neither Congress nor the courts ever intended that claims for future rent or for damages for the loss thereof should be provable or dischargeable. The reasons and explanations therefor as given by the various courts are unimportant. It is the intent of Congress which governs and a practical rule is frequently more desirable than a general rule of logic consistently applied to all similar legal relationships.

There is one more important principle certainly implied, if not expressed, in this Court's review of the intent of Congress as expressed in the Bankruptcy Act. Congress intended to make only certain definite types of claims provable. All other types of claims, including this one, were to be unprovable. It was not to be a question of the phraseology of the covenant upon which a claim might be founded, or a question of analogy to other types of claims, but rather a question of determining the intent of Congress,

as expressed, with respect to the substance of each type of claim. For instance, tort claims, unless merged into judgments, have been deemed not to have been included by Congress within the list of provable claims. Claims for workmen's compensation, even though liquidated by an award of the duly constituted state authority, were also regarded as unprovable. Likewise, as has been definitely and finally established, claims for damages for loss of future rent were nowhere included by Congress within the provisions of Section 63a and we cannot be so blind to essential matters as to assume that Congress intended to exclude a claim only in the event the proper language or clause was omitted. Congress was dealing with matters of substance. Methods of expression may be important but the administration of the bankruptcy law must be more concerned with substance.

It is, therefore, clear that the language and theory of the *Manhattan Properties* case require the reversal of the judgment below.

B. The intent to exclude claims for damages for loss of future rent prior to June, 1934 was unmistakably corroborated in the amendments to the Bankruptcy Act of June 7 and 18, 1934.

Since the decision in *Manhattan Properties, Inc.* v. *Irving Trust Company, supra,* there has been presented further evidence of the intent of Congress to exclude the instant claim from the category of provable claims defined in Section 63a of the Bankruptcy Act as applicable to this bankruptcy proceeding. It can be shown that, by recent amendments to Section 63a. Congress has made provable

for the first time claims for damages for the loss of future rent and then only in an amount not exceeding rent for one year after the date of surrender of the premises and only in bankruptcy proceedings in which the six months period had not expired at the time of the enactment of the amendments.* Obviously, if an amendment to the Bankruptcy Act was deemed necessary by Congress to make this claim provable in the future, this claim could not have been intended by Congress to have been provable in this bankruptcy proceeding in which the time to file claims expired March 31, 1933 (R. 1). *First National Bank* v. *Missouri* (1923), 263 U. S. 640, 658. The intent of Congress as set forth by this Court in the *Manhattan Properties* case is thus confirmed.

The truth of such conclusion is obvious when it is realized that Congress unmistakably included this type of claim within a new amendment adding new types of hitherto unprovable claims to the provable list; unmistakably indicated its belief that such amendment was a change in the existing law and unmistakably made such new amendment not applicable to this bankruptcy proceeding. If this claim had been provable in this case, Congress would not have so acted or expressed itself.

By Acts of Congress approved June 7 and 18, 1934 three new clauses [numbered (6), (6½) and (7)] were added to Section 63a of the Bankruptcy Act. Each of such new clauses dealt with a type of claim not provable prior to the enactment of such amendments.** Clause (6) made

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*Therefore, not applicable to this proceeding since the time for filing claims herein expired more than a year prior to the enactment of the amendments.

**The new clauses thus added to Section 63a are set forth in full in Appendix A.

provable workmen's compensation claims when founded upon the award of an industrial commission, other body or officer of any State or Territory having jurisdiction to make such awards. Clause (6½) made provable claims for damages evidenced by a judgment in any action for negligence instituted prior to the adjudication in bankruptcy and pending at the time of the filing of the petition in bankruptcy. Clause (7) referred to the instant type of claim and made provable claims for damages arising under executory contracts, including leases, but limited claims for damages or indemnity under a covenant contained in a lease to the rent stipulated in the lease, without acceleration, for the year next succeeding the date of the surrender of the premises plus an amount equal to the unpaid rent accrued up to said date.

New clause (7) is the only subdivision of Section 63a from which, strictly speaking, the past and present intent of Congress regarding future rent claims can be ascertained. But, in passing, it should be noted that the claims covered by new clauses (6) and (6½) were clearly not provable prior to the 1934 amendments. *Lane* v. *Industrial Commissioner,* (1931), 54 Fed. (2nd) 338, cer. denied 286 U. S. 543; *Schall* v. *Camors,* (1920), 251 U. S. 239. Since this is true in respect of two out of three new clauses, it is certainly persuasive, particularly in view of the recent agitation regarding landlords' claims and the obvious meaning of the *Manhattan Properties* case, that the same was intended to be true as to the third new clause, *i.e.,* clause (7).

But there are other evidences that by the enactment of clause (7) Congress intended for the first time to make claims for damages for loss of future rent (including this claim) provable in what may be termed "future bankrupt-

cies." This may be demonstrated by the establishment of two major propositions with respect to clause (7):

> (a) It was intended by Congress to change the then existing law and to add a new type of provable claim. (If such be the case, such type of claims could not have theretofore been provable.)
>
> (b) It was intended to include the instant type of claim within the definition of such new type of provable claim. (The instant type of claim was therefore not provable prior thereto.)

The first proposition is easily made apparent as it has been stated by Congress in almost *haec verba*. When the new amendments to Section 63a were first presented to the House of Representatives (H. R. 5884), clause (7) was plainly designated as one of a number of "changes in existing law" (House Report 194, 73rd Congress, 1st Session). Such designation, it is submitted, is conclusive of the intent of the House and, inasmuch as Senate Report 482 (73rd Congress, 2nd Session) reprinted House Report 194 as the sole explanatory note concerning the new amendments, equally conclusive as to the intent of the Senate. It is difficult to understand how, after such designation with respect to clause (7), any one can argue that Congress intended merely to clarify one of the other subdivisions of Section 63a which it believed had been erroneously interpreted by the courts.

In addition, the last proviso of clause (7) clearly indicates the belief of Congress that such clause dealt with an entirely new and different claim not theretofore provable. Such last proviso was approved in one form on June 7, 1934 and was later amended by an Act (S. 3779) approved

on June 18, 1934. In both its forms the last proviso clearly indicates the intent of Congress to create a new type of claim by clause (7). Such proviso, as first enacted, read as follows:

> "*Provided further,* That the provisions of this clause (7) shall apply to estates pending at the time of the enactment of this amendatory Act."

By the Act approved June 18, 1934 the applicability of clause (7) was limited "to estates pending at the time of the enactment of this amendatory Act in which the time for filing such claims has not expired." In reporting favorably upon this last amendment to clause (7) (S. 3779), the Senate Judiciary Committee said (Senate Report 1404; 73rd Congress, 2nd Session):*

> "The committee is of opinion that the provisions of clause (7), quoted above, should be limited in operation to those estates in which the time for filing claims has not expired. If applied to estates in which the time for filing claims has expired, these provisions would entail much inconvenience, expense, and confusion, in many cases necessitating the reopening of estates which are ready for final settlement and in which the time for filing claims expired many months ago. The sole purpose of this bill (S. 3779) is to avoid such undesirable results of the provisions of clause (7)."

Furthermore, upon the passage of the bill by the House, it was stated by the member moving its adoption that this amendment, limiting the application of clause (7), had by inadvertence been left out of the bill approved June 7, 1934 and that the amendment limited

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*House Report 2018, 73rd Congress, 2nd Session, is identical in language.

> "landlords filing their claims against bankrupt estates"

to proceedings in which the six months period had not expired (Congressional Record, Vol. 78, 73rd Congress, 2nd Session, p. 12078).

It is submitted that such last proviso of clause (7) would never have been passed in either its first or final form if Congress had not *thought* it was providing for a new type of claim in clause (7). If clause (7) was intended merely as a clarification of the first five subdivisions applicable to this case, the last proviso would have so stated. This becomes even more obvious when it is realized that such proviso was never proposed until the entire Act was passed in different forms by the Senate and the House and submitted to conference (Appendix B, cf. Nos. 3 and 4). In addition, the final form of the last proviso clearly provides that none of the provisions of clause (7) shall be applicable to estates in which the time for filing claims has expired. This is conclusive evidence that a new form of claim was created.

Some argument may be made to the contrary by insisting that clause (7) does not make provable a new type of claim inasmuch as a logical dissection of its language would include within the scope thereof claims of the type heretofore held provable in cases like *Central Trust Co.* v. *Chicago Auditorium Association* (1916), 240 U. S. 581. Such argument clearly ignores the designation of clause (7) as a "change in the existing law" and the form of the last proviso. It is realized that the language used by Congress in clause (7) is not as definite as might be desired. Nevertheless, it should be obvious from all of the foregoing that in spite of the loose reference to "executory contracts" there was no intent on the part of Congress to include within the

scope of clause (7) claims for damages similar to those presented in the *Chicago Auditorium* case.

It is also believed that the second proposition *i.e.,* that Congress intended to include the instant claim within the scope of clause (7), is equally clear. Unfortunately for its grammatical structure, clause (7) suffered an almost mushroom growth as a result of a number of amendments* and was not debated on the floor of either the House of Representatives or the Senate. It was first proposed and passed in very short form (H. R. 5884; Appendix B, No. 1); was modified first by an amendment of the Senate Committee on the Judiciary (Senate Report 482, p. 3, 73rd Congress, 1st Session; Appendix B, No. 2); was further changed on the floor of the Senate (Vol. 78, Congressional Record, 73rd Congress, 2nd Session, pp. 8109-8110; Appendix B, No. 3) was again modified by the Conference Committee of both houses (House Report 1821, 73rd Congress, 2nd Session; Appendix B, No. 4). Consequently the clause is difficult, if not impossible, to parse and must be read and interpreted in the light of the general background of recent events in bankruptcy law, such as the *Manhattan Properties* case and the general attack by landlords on the statutory exclusion of their claims from provability in corporate bankruptcies. When so examined there is no doubt but that Congress intended to include the instant claim within its permissive and restrictive provisions.

The clause as finally passed may be divided into four parts—

> (1) A general provision as to the type of claims made provable thereby (suggested and passed first by the House of Representatives);

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*The various forms through which clause (7) passed, are set forth in detail in Appendix B.

(2) A limitation as to the amount in which certain of such type of claims, *i.e.*, claims for damages for the loss of future rent, could be allowed (suggested first on the floor of the Senate);

(3) A declaration of policy with respect to the amount in which assigned future rent claims should be allowed (suggested first in conference after passage by both the Senate and the House); and

(4) A limitation of the applicability of the clause to bankruptcies in which the six months period for filing claims had not expired; thus excluding reference to this bankruptcy (partially first proposed in conference and modified by the subsequent amendment of June 18, 1934).

The first part of clause (7), *i.e.*, the general description of the type of claims made provable, was not changed from the form in which it was originally introduced and passed in the House. The phrase "claims for damages respecting executory contracts including future rents" has no punctuation and is most inartistic. Yet the words "future rents" must refer to damages and not to "executory contracts". Otherwise, the phrase is incoherent and meaningless. And it is well known that the term "future rents" has been customarily used in bankruptcy practice to refer not only to the entire rent to accrue under a lease in the future but also to damages for the loss of such rent resulting from bankruptcy. Congress obviously used the term in the same sense and the reference to "future rents" indicates an intent on the part of Congress to deal with all claims for damages arising out of a lease including a claim for rent which, except for the bankruptcy, would have

accrued in the future. Congress was familiar with all the various types of clauses inserted in leases in an effort to give landlords provable claims in bankruptcy, including those presented in the *Manhattan Properties* case; *Kothe* v. *Taylor Trust, supra; Filene's Sons Co.* v. *Weed* (1918), 245 U. S. 597; *In re Schechter* (C. C. A. 3rd Cir.-1930), 39 Fed. (2nd) 18. In all but the *Schechter* case (and then on a theory contrary to the *Manhattan Properties* case), the claims of the landlords had been held not provable in bankruptcy. Congress intended to make all such claims provable in the future, whether or not special covenants were included in the leases. A most comprehensive clause was selected. The sentence structure may be awkward but the intent is clear.

Furthermore, it will be noted that in the third part of clause (7), *i.e.,* the declaration of policy with respect to the amount in which assigned future rent claims could be allowed, Congress speaks first of "future rent claims" and then of "the amount of damages allowed assignee hereunder", thus clearly indicating that Congress intended to include all claims for damages for the loss of future rent (however they might arise) within the generally descriptive and all-inclusive phrase "future rent claims".

Having made all claims for loss of future rent as a result of bankruptcy provable, it was evident that such claims would have to be limited in amount. Otherwise the landlords would compel a return of their property and, in these days of long leases and numerous leaseholds, would by enormous claims (*e.g.,* the instant one) absorb the entire estate in bankruptcy to the detriment of other creditors. The first provision of limitation suggested by the Senate Committee on the Judiciary (Appendix B, No. 2) referred

only to an "anticipatory breach of an unexpired lease". This was obviously insufficient as claims might otherwise arise by express covenant. It was also confusing as bankruptcy had been held not to be an anticipatory breach of a lease. *Central Trust Co.* v. *Chicago Auditorium Association, supra; Manhattan Properties, Inc.* v. *Irving Trust Company, supra.* So the restrictive clause was amended on the floor of the Senate (Appendix B, No. 3) and sought to be made all-inclusive as to future rent claims.

It was realized that a single descriptive phrase might not be sufficient. It was desired to cover both claims arising in the absence of a special covenant and claims arising on special covenants for damages or indemnity. The phrase "claim of a landlord * * * for damages * * * under a covenant contained in such lease" is a perfect description of this claim and was intended as such. Obviously, all claims thus defined in the clause limiting them as to amount were included in the general description of the new claims permitted to be provable in the future, *i.e.*, "claims for damages respecting executory contracts including future rents".

Some argument may be made that the term "such lease" refers only to "an unexpired lease" and consequently could not refer to a lease such as the instant one which by its terms expired on the filing of the bankruptcy petition. Yet no one, realizing the purpose of the restrictive clause, would think seriously for a minute that Congress intended the whole purpose of this provision of limitation to be entirely evaded by the simple device of making the lease terminate on bankruptcy. If such were once permitted, we are all sufficient students of human behavior to know that all leases would provide for automatic termination on bankruptcy and the restrictive provision would be useless. Dam-

ages to landlords would then be provable in the extreme. As previously pointed out, imagine the effect of unrestricted claims based on 99 and 999 year leases. Furthermore, the landlord, in spite of possible assertions to the contrary, would not run any risk by such provision for automatic termination. Even without the instant provision, if a lease should be burdensome to the bankrupt estate, it would be terminated as a practical matter in the case of a corporate lessee by disaffirmance by the receiver or trustee. Likewise, if such lease should be advantageous to the estate, the landlord would desire termination so as to negotiate new and higher rentals with the estate or third parties, if the estate were liquidated. Such construction would enable the landlord "to eat his cake and have it too". Congress obviously intended no such result. The reference must be construed to mean all leases which, except for the bankruptcy, would not have expired. As so construed, the restrictive clause is intelligible, practicable and wise. If construed otherwise, the clause is impracticable, confusing, unworkable and fails to accomplish its only purpose.

Furthermore, even if the restrictive provisions of clause (7) be construed not to refer to this type of claim and covenant, nevertheless the first part of clause (7)—defining the claims provable in the future—does refer to this claim. That language is so broad as to be susceptible of only that conclusion. This claim is clearly one for damages for loss of future rents and arose under a contract usually termed "executory". As previously stated, this is also indicated by the reference to all "future rent" claims and "claims for damages" under clause (7) as synonymous in the provision relating to the allowance of assigned claims. Since that is true, it is not necessary to go further.

If this claim is included within the first and permissive part of clause (7), it was not intended by Congress to be provable until the enactment of such clause (7).

One more thing should be noted. If, perchance, the instant claim is not included within clause (7), it is not provable in this or any other bankruptcy, past or future. By the *Manhattan Properties* decision, it was not provable prior to the enactment of clause (7) and, if clause (7) relates only to executory contracts or unexpired leases and not to leases which automatically terminate on bankruptcy, Congress by dealing with one type of a future rent claim impliedly excluded this one.

To recapitulate, the intent of Congress as expressed in the *Manhattan Properties* case has been confirmed by Congress. By new amendments not applicable to this case, Congress has made the instant type of claim provable in a limited amount in future bankruptcies. Therefore, this claim could not have been provable prior to such amendments.

IV

The judgment of the Circuit Court of Appeals should be reversed and the instant claim should be expunged.

Respectfully submitted,

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Amici Curiae.

The undersigned counsel for the petitioner and counsel for the respondent hereby acknowledge service of, and consent to the filing of, the foregoing brief of Walter E. Hope and H. Struve Hensel, as *amici curiae*.

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APPENDIX A

The changes in existing law made by the Acts approved June 7 and 18, 1934, involved, among other things, the addition of three new subdivisions to Section 63a as follows:

> "(6) founded upon an award of an industrial accident commission, or other commission, body or officer, of any State or Territory having power or jurisdiction to make awards as workmen's compensation in case of injury or death for injury prior to adjudication; (6½) the amount of any damages, as evidenced by a judgment of a court of competent jurisdiction, in any action for negligence instituted prior to adjudication of defendant in such action in bankruptcy and pending at the time of the filing of petition in bankruptcy, whether voluntary or involuntary; and (7) claims for damages respecting executory contracts including future rents whether the bankrupt be an individual or a corporation, but the claim of a landlord for injury resulting from the rejection by the trustee of an unexpired lease of real estate or for damages or indemnity under a covenant contained in such lease shall in no event be allowed in an amount exceeding the rent reserved by the lease, without acceleration, for the year next succeeding the date of the surrender of the premises plus an amount equal to the unpaid rent accrued up to said date: *Provided,* That the court shall scrutinize the circumstances of an assignment of future rent claims and the amount of the consideration paid for such assignment in determining the amount of damages allowed assignee hereunder: *Provided further,* That the provisions of this clause (7) shall apply to estates, pending at the time of the enactment of this amendatory Act in which the time for filing such claims has not expired."

APPENDIX B

1. New clause (7) of Section 63a as adopted by the House of Representatives on June 5, 1933, read as follows (H. R. 5884):

   "(7) claims for damages respecting executory contracts including future rents whether the bankrupt be an individual or a corporation, which claims shall be liquidated under Section 63b of this Act."

2. New clause (7) of Section 63a as suggested by the Senate Committee on the Judiciary (Senate Report 482, 73rd Congress, 2nd Session, p. 3):

   "(7) claims for damages respecting executory contracts including future rents whether the bankrupt be an individual or a corporation, but the claim of a landlord for anticipatory breach of an unexpired lease of real estate shall in no event be allowed in an amount exceeding the rent reserved by the lease for the year next succeeding the date of the surrender of the premises."

3. New clause (7) of Section 63a as amended on the floor of the Senate (Vol. 78, Congressional Record, 73rd Congress, 2nd Session, pp. 8109-8110) and as passed by the Senate:

   "(7) claims for damages respecting executory contracts including future rents whether the bankrupt be an individual or a corporation, but the claim of a landlord for injury resulting from the rejection by the trustee of an unexpired lease of real estate or for damages or indemnity under a covenant contained in such lease shall in no event be allowed in an amount exceeding the rent reserved by the lease for the year

next succeeding the date of the surrender of the premises plus an amount equal to the unpaid rent accrued up to said date."

4. New clause (7) of Section 63a as recommended in the conference report (House Report 1821, 73rd Congress, 2nd Session) and approved by the President on June 7, 1934 (with the further amendment by S. 3779 approved by the President on June 18, 1934 in italics):

"(7) claims for damages respecting executory contracts including future rents whether the bankrupt be an individual or a corporation, but the claim of a landlord for injury resulting from the rejection by the trustee of an unexpired lease of real estate or for damages or indemnity under a covenant contained in such lease shall in no event be allowed in an amount exceeding the rent reserved by the lease, without acceleration, for the year next succeeding the date of the surrender of the premises plus an amount equal to the unpaid rent accrued up to said date: Provided, That the court shall scrutinize the circumstances of an assignment of future rent claims and the amount of the consideration paid for such assignment in determining the amount of damages allowed assignee hereunder: Provided further, That the provisions of this clause (7) shall apply to estates pending at the time of the enactment of this amendatory Act *in which the time for filing such claims has not expired.*"

Supreme Court of the Unit

October Term, 194

No. 22.

IRVING TRUST COMPANY, as Tem
rupcy of Ontiveros Operating Co

A. W. PERRY, INC.

On Writ of Certiorari to the United States C
Appeals for the Second Circ

Motion and Brief of Amici Curiae in
Reargument

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In the

Supreme Court of the United States.

October Term, 1934.

No. 22.

IRVING TRUST COMPANY, as Trustee in Bankruptcy of OUTFITTERS OPERATING REALTY CO., INC.,
Petitioner,
v.
A. W. PERRY, INC., *Respondent.*

MOTION FOR LEAVE TO FILE BRIEF AS AMICI CURIAE.

Now come Thomas Hunt and Earle W. Carr, and move this Honorable Court for leave to file the annexed brief as *amici curiae,* the consent in writing of counsel for the petitioner and of counsel for the respondent having first been obtained. The undersigned ask this leave as counsel for Frederic E. Snow and Sidney E. Shuman, Trustees of the A. Shuman Real Estate Trust, who filed a claim in the United States District Court for the Southern District of New York in bankruptcy proceedings entitled: "In the Matter of Louis K. Liggett Company, Bankrupt—In Bankruptcy No. 56,900." This claim is based on a clause in a lease identical with that contained in the lease involved in this case, except that the *ipso facto* termination of the lease was accomplished by the adjudication of the bank-

ruptcy of the lessee rather than by the filing of the petition. Judge Knox held that this claim was provable in an order entered May 18, 1934, relying upon the decision of the United States Circuit Court of Appeals for the Second Circuit which this Court is now reviewing. Counsel for the Trustees in Bankruptcy of the Louis K. Liggett Company have heretofore filed a brief as *amici curiae*.

THOMAS HUNT,
EARLE W. CARR,
Office and Post Office Address,
82 Devonshire Street, Boston, Mass.

Boston, Mass., September 28, 1934.

In the

Supreme Court of the United States.

October Term, 1934.

No. 22.

IRVING TRUST COMPANY, as Trustee in Bankruptcy of OUTFITTERS OPERATING REALTY CO., INC., *Petitioner,*

v.

A. W. PERRY, INC., *Respondent.*

BRIEF OF THOMAS HUNT AND EARLE W. CARR AS AMICI CURIAE IN SUPPORT OF RESPONDENT.

Opinions Below.

Neither the opinion of the Referee (R. 13-23) nor the opinion of the District Court (R. 26) is reported. The opinion of the United States Circuit Court of Appeals (R. 31-34) is reported in 69 Fed. (2d) 90.

Statement of Facts.

The respondent, A. W. Perry, Inc., leased in 1929 to the bankrupt Outfitters Operating Realty Co., Inc., certain premises at No. 459 Washington Street, Boston, Massachusetts, for a term ending December 31, 1944, at a specified

progressive rental (R. 6-11).

The lease contained the following clause (R. 10):

> ". . . and, for the more effectual securing to the Lessor of the rent and other payments herein provided, it is agreed as a further condition of this lease that the filing of any petition in bankruptcy or insolvency by or against the Lessee shall be deemed to constitute a breach of this lease, and thereupon, ipso facto and without entry or other action by the Lessor, this lease shall become and be terminated; and, notwithstanding any other provisions of this lease, the Lessor shall forthwith upon such termination be entitled to recover damages for such breach in an amount equal to the amount of the rent reserved in this lease for the residue of the term hereof less the fair rental value of the premises for the residue of said term."

The bankrupt filed a voluntary petition in bankruptcy in the United States District Court for the Southern District of New York on September 30, 1932, and was adjudicated bankrupt the same day (R. 1).

On March 29, 1933, the respondent filed a claim in the sum of $177,788, based on the provision of the lease above quoted (R. 4-11). The petitioner moved to expunge the claim and a hearing was had before the Referee at which it was stipulated that the objection there raised was solely to the provability of the claim, the question of the amount being reserved (R. 12, 13).

The claim was expunged by the Referee (R. 13-23), and his order was affirmed by the District Court (R. 26-27). However, the Circuit Court of Appeals reversed both the Referee and the District Court and held that the claim was provable (R. 31-35). The opinion by L. Hand, J., stated that this court had held in *Manhattan Properties, Inc.*, v.

Irving Trust Company, 291 U.S. 320, that claims for future rent are ordinarily not provable, and can become so, if at all, only by virtue of special clauses; that the question of the validity of such a clause as that used in the instant case had been specifically reserved by this Court; that the clause in the instant case avoided the uncertainties that had made other clauses ineffective, since the claim was not contingent either in right or in amount at petition filed. Therefore the claim was held provable and the covenant was interpreted as providing for damages consisting of the sum of a discounted series of installments, each made up of the rent reserved, less the fair rental value for that period.

Question Presented.

Does respondent have a claim provable in bankruptcy under section 63 of the Bankruptcy Act based upon the special clause used in the instant case?

Statute Involved.

Section 63 of the Bankruptcy Act, as applicable to this case, provides:

> "Debts which may be proved.—a. Debts of the bankrupt may be proved and allowed against his estate which are (1) a fixed liability, as evidenced by a judgment or an instrument in writing, absolutely owing at the time of the filing of the petition against him, whether then payable or not, with any interest thereon which would have been recoverable at that date or with a rebate of interest upon such as were not then payable and did not bear interest; * * * (4) founded upon an open account, or upon a contract express or implied; * * *

"b. Unliquidated claims against the bankrupt may, pursuant to application to the court, be liquidated in such manner as it shall direct, and may thereafter be proved and allowed against his estate."

Section 1 (11) provides:

"'debt' shall include any debt, demand, or claim provable in bankruptcy."

Section 17 provides:

"A discharge in bankruptcy shall release a bankrupt from all of his provable debts, * * *"

with exceptions not here material (Act of July 1, 1898, sections 1, 17 and 63, 30 Stat. 562, as amended, U.S.C.A. Title 11, sections 1, 35 and 103).

On June 7 and 18, 1934, section 63 was amended by adding the following sub-sections, which have no bearing on this case except in so far as they tend to disclose the intent of Congress with respect to the meaning of section 63 prior to these amendments.

"(6) founded upon an award of an industrial accident commission, or other commission, body or officer, of any State or Territory having power or jurisdiction to make awards as workmen's compensation in case of injury or death for injury prior to adjudication; (6½) the amount of any damages, as evidenced by a judgment of a court of competent jurisdiction, in any action for negligence instituted prior to adjudication of defendant in such action in bankruptcy and pending at the time of the filing of petition in bankruptcy, whether voluntary or involuntary; and (7) claims for damages respecting executory contracts including future rents whether the bankrupt be an individual or a

corporation, but the claim of a landlord for injury resulting from the rejection by the trustee of an unexpired lease of real estate or for damages or indemnity under a covenant contained in such lease shall in no event be allowed in an amount exceeding the rent reserved by the lease, without acceleration, for the year next succeeding the date of the surrender of the premises plus an amount equal to the unpaid rent accrued up to said date: Provided, That the court shall scrutinize the circumstances of an assignment of future rent claims and the amount of the consideration paid for such assignment in determining the amount of damages allowed assignee hereunder: Provided Further That the provisions of this clause (7) shall apply to estates, pending at the time of the enactment of this amendatory Act in which the time for filing such claims has not expired."

Summary of Argument.

This claim is not a claim for future rent. It is for liquidated damages based on a clause in the lease which automatically terminated the lease (and therefore the lessee's liability to pay rent) on the filing of the petition in bankruptcy by the lessee and contemporaneously raised an obligation to pay the damages thereby suffered.

This Court in the recent case of *Manhattan Properties, Inc.*, v. *Irving Trust Company*, 291 U.S. 320, recognized the distinction between claims based on covenants to pay *rent* on the one hand and claims based on clauses like the one here involved, holding the former not provable and specifically reserving the question of the provability of the latter. The reasoning used by this Court in arriving at its decision in the Manhattan Properties case strongly supports the provability of the instant claim.

There is no logical objection to the provability of this claim. It is certain in obligation and amount at petition filed.

There is no historical foundation for holding the claim not provable; on the contrary, the failure of Congress to amend section 63 of the Bankruptcy Act in the face of strongly expressed dicta that claims like the instant one would be provable is strong evidence that such dicta correctly interpreted the legislative intent.

The 1934 amendments to section 63 of the Bankruptcy Act show that Congress considered that claims like the instant one were provable before such amendments.

It is proper for the parties to a lease to insert special covenants therein which give the lessor a provable claim in bankruptcy even though without such provisions the lessor would have no provable claim to compensate him for his loss of rents.

The covenant in the instant case liquidates the damages upon a footing that is familiar and fair.

Argument.

I. This claim is not a claim for future RENT. *It is not based upon a covenant to pay rent, but upon a covenant to pay damages upon the ipso-facto termination of the lease by bankruptcy.*

It is necessary at the outset to place emphasis upon this obvious fact because of the distinction which exists between covenants to pay rent and covenants such as the one upon which this claim is based. It is a matter, not of phraseology, but of substance. The petitioners in *Manhattan Properties, Inc.*, v. *Irving Trust Co.*, 291 U.S. 320, strenuously urged that there was no sound reason consistent with the purposes of the Bankruptcy Act why any distinction should be made between the claim of a landlord for future rent and claims

founded on any other executory contract. This Court rejected that broad contention and recognized the effect in bankruptcy of the technical law as to leases, which, as this Court remarked in *Gardiner* v. *Butler & Co.*, 245 U.S. 603, is not a matter of logic *in vacuo* but a matter of history that has not forgotten Lord Coke.

The proof of claim filed contains the following rather inaccurate language (R. 5):

> ". . . that the consideration of said debt is as follows: Damages for breach of covenant to pay rent under a lease, a copy of which is hereto annexed . . ."

In a brief filed in this case by Walter H. Hope and H. Struve Hensel as *amici curiae* it is urged (p. 8) that this claim is not provable on its face, because of the above-quoted language in the proof of claim. Of course respondent is not bound by the descriptive language used in its proof of claim. In *Watson* v. *Merrill* (C.C.A. 8th), 136 Fed. 359, the court said (p. 360):

> "It is, however, the nature of the claim, and not the name which is applied to it, that conditions its provability in bankruptcy."

This case was decided below and is argued here by the petitioners as a claim based on the ipso-facto covenant. Whether there is sufficient difference between a simple covenant to pay rent and the ipso-facto clause and covenant in the lease here involved to permit a provable claim to be founded on the latter is the point before this Court for determination; it serves only to obscure the issue to seize upon inaccurate language in the proof of claim as an admission that the claim is for damages for breach of a covenant to pay rent and therefore not provable under the decision in the Manhattan Properties case, *supra.*

II. The decision in the Manhattan Properties case, while not decisive of the case at bar, strongly supports the provability of this claim.

Consideration of this case starts logically with the latest decision of this Court on the subject, *Manhattan Properties, Inc.*, v. *Irving Trust Co.* and *Samuel R. Brown et al.* v. *Irving Trust Co.*, 291 U.S. 320.*

This decision involved two claims. The first claim was based on a lease which had about five years and a half to run at the time the lessee was adjudicated bankrupt in an involuntary proceeding. The lease contained a covenant that, if bankruptcy proceedings were instituted by or against the tenant, the landlord might re-enter and relet as agent for the tenant and—

> "The Tenant further agrees to pay each month to the Landlord the deficit accruing from the difference between the amount to be paid as rent as herein reserved and the amount of rent which shall be collected and received from the demised premises for such month during the residue of the term herein provided for after the taking possession by the Landlord; the overplus, if any, at the expiration of the full term herein provided for shall be paid to the Tenant unless the Landlord within a period of six months from the termination of this lease as provided herein shall, by a notice in writing, release the Tenant from any and all liability created by this provision of the lease, which it is agreed the Landlord shall, at the Landlord's option, have the right to do, in which event it is agreed that the Landlord and the Tenant shall have no further rights and liabilities hereunder."

* These two cases were argued and decided together. The decision is referred to elsewhere in this brief for convenience by the title of the first case or simply as the Manhattan Properties case.

The lessor filed a claim for $25,000 damages for loss of future rentals, computing the amount by subtracting the present rental value of the leased premises from the rent reserved in the lease for the balance of the term.

The second claim was based on a lease which had about twelve years and nine months to run at the time the lessee was adjudicated bankrupt upon its voluntary petition. The lease contained a covenant that, if the lessee were adjudicated bankrupt, the lessor might enter—

> ". . . and upon entry as aforesaid this lease shall determine, and the Lessee covenants that in case of such termination it will indemnify the Lessor against all loss of rent which the Lessor may incur by reason of such termination, during the residue of the term above specified."

The lessor filed a claim which contained an item of $4404.40 representing the difference between the rent accrued to the date of re-entry and collections from occupants during the period and an item of $143,615.80 representing the difference between the alleged rental value for the remainder of the term and the rent reserved in the lease.

The opinion of this Court, after stating the facts and quoting the applicable sections of the Bankruptcy Act, noted that a majority of the Circuit Court of Appeals had felt bound to follow its earlier decision, *In re Roth & Appel*, 181 Fed. 667. The reasons relied on in that opinion were reviewed. The Court then stated the equitable grounds which had been urged both for and against the provability of future rent claims. It was conceded that the construction of the Bankruptcy Act for which the lessors contended was logically an admissible one, but that the sole inquiry was the intent of Congress. The Court then made a careful inquiry into the legislative history of the present Bank-

ruptcy Act and its predecessors in the light of the court decisions. It was found that the lower federal and state courts had considered future rent claims not provable under the Bankruptcy Acts of 1800, 1841 and 1867 and that no provision for future rent claims was made in the Act of 1898. After the passage of the Act of 1898 it was noted that the great majority of the lower federal courts, including the Circuit Courts of Appeals in six circuits, had held that future rent claims were not provable under the Act of 1898. During the period between 1898 and 1932 the Bankruptcy Act was amended eight times without alteration of section 63 (a). This Court then concluded that the construction of the statute so long and so generally accepted was highly persuasive that the construction of the courts correctly interpreted the intent of Congress. Therefore this Court approved the great weight of lower-court authority holding that future rent claims were not provable.

The Court then passed to consideration of the effect of the specific indemnity covenants contained in the two leases. It was pointed out that they did not provide for liquidation of damages and that they became effective only on optional re-entry by the lessor. These defects were held to be fatal to the provability of the claims. The Court concluded with this statement (p. 338):

> "There can be no debt provable in bankruptcy arising out of a contract which becomes effective only at the claimant's option and after the inception of the proceedings, the fulfilment of which is contingent on what may happen from month to month or up to the end of the original term. Compare In re Ells, supra; Slocum v. Soliday, supra; In re Roth & Appel, supra. Such a covenant is not, as petitioners contend, the equivalent of an agreement that bankruptcy shall be a breach of the lease and the consequent damages to

> the lessor be measured by the difference between the present value of the remainder of the term and the total rent to fall due in the future. The covenants appearing in the leases in question cannot be made the basis of a proof of debt against the estate."

The decision of this Court in the Manhattan Properties case falls logically into two parts:

(1) Claims founded upon covenants to pay future rent are not provable in bankruptcy.

(2) The specific indemnity covenants contained in the leases in that case were not sufficient to support provable claims.

Petitioner endeavors to merge these two points by saying (p. 12):

> "It is manifest, therefore, that regardless of the scope of the precise holding in the Manhattan Properties case, this Court had no intention of distinguishing generically between claims for future rent and claims for damages for breach of rent covenants, nor is there any basis in the history of the doctrine, as is manifest from the opinion itself, to justify a distinction."

If by "rent covenants" petitioner means covenants to pay rent, the statement is of course correct, but inapplicable to the claim involved in this case, because the covenant here concerned is not a covenant to pay rent at all, but a covenant to pay damages which does not come into operation until the lease has been terminated by the ipso-facto clause. On the other hand, if petitioner intends "rent covenants" to be broad enough to include a covenant which has no connection with rent other than the fact that its purpose is to secure the lessor against loss of rents, it is submitted that this Court did intend to distinguish gener-

ically between claims for future rent and claims for damages for breach of such covenants.

If this Court intended to hold in the Manhattan Properties case that there could be no distinction between claims for future rent and claims based on special covenants, the critical examination of the covenants in the last pages of the Court's opinion would have been superfluous. It is obvious that this Court considered the two points decided separate and distinct from the transitory sentence used when passing from consideration of the provability of future rent claims in general to consideration of the specific covenants (p. 337).

> "It *remains* to consider the effect of the indemnity covenants in the leases." (Italics supplied.)

L. Hand, Circuit Judge, correctly described the scope and effect of the Manhattan Properties decision in the opinion below (R. 31, 32):

> "Meanwhile the Supreme Court on February 5, 1934, affirmed our decision in Manhattan Properties v. Irving Trust Co., and has thus finally settled it that claims for future rent are not ordinarily provable, and can become so, if at all, only by virtue of special clauses. The question here is whether this clause will serve; its possible validity was specifically reserved in the Supreme Court's opinion."

The Circuit Court of Appeals for the Second Circuit announced in *Wright* v. *Irving Trust Co.*, 70 Fed. (2d) 245, 246, that it interprets the Manhattan Properties opinion as indicating that provable claims may arise under leases if the obligation be certain in both event and amount at petition filed:

"However, we have twice already held that provable claims may arise under leases, *if the obligation be certain in both event and amount at petition filed.* In re Outfitters' Operating Realty Co. (A. W. Perry, Inc. v. Irving Trust Co.) (C.C.A.) 69 F. (2d) 90; Winston-Salem Masonic Temple Co. v. Irving Trust Co. (C.C.A.) 69 F. (2d) 484. Part of the discussion in Manhattan Properties, Inc. v. Irving Trust Co., supra, 290 U. S. —, 54 S. Ct. 385, 78 L. Ed.—, certainly gives color to that notion, and we shall take it as the proper test, until the Supreme Court decides otherwise." (Italics supplied.)

It is submitted that the court below has correctly interpreted and applied the decision of this Court in the Manhattan Properties case.

III. There is no logical objection to the provability of this claim. The covenant upon which it is based avoids all the defects which have been found in simple rent claims or claims based upon indemnity covenants.

The determination of what claims are provable under section 63 of the Bankruptcy Act is ultimately one of determining the intent of Congress. This Court determined the intent of Congress with respect to the claims involved in the Manhattan Properties case largely on a historical basis —the legislative evolution of the Bankruptcy Laws in the light of the court decisions on the subject known to Congress when amendments were made. The bearing of such an analysis on the claim to be adjudicated in this case is considered hereafter in this brief. It is here urged that none of the reasons which have been advanced by the courts in holding claims based on rent or indemnity covenants not provable are applicable to the instant case.

The most frequently expressed reason for holding future rent claims not provable is the doctrine traceable to Lord Coke that rent is the consideration for the actual use and enjoyment of land and is deemed to come out of the profits of the estate. *Wm. Filene's Sons* v. *Weed*, 245 U.S. 597, 601. Consequently, until the time for payment arrives, the rent is not only not yet payable, but there is no debt or obligation whatever. True, there may be a debt in the future, but if for any reason the right to occupy should terminate, the obligation to pay would cease. Hence it was held that, if the tenant became bankrupt, the landlord had no claim for unaccrued rent, because of the uncertainty as to whether there would ever be any obligation to pay.

In re Roth & Appel, 181 Fed. 667 (C.C.A. 2).
Slocum v. *Soliday*, 183 Fed. 410 (C.C.A. 1).
Manhattan Properties, Inc., v. *Irving Trust*, 291 U.S. 320.

This is a defect that necessarily inheres in covenants to pay future rent, but only in covenants to pay *rent*. In order for a lessor to have a provable claim against his lessee, all that is necessary is that there be sufficient certainty about the obligation at the time of bankruptcy.

Under the provision of the lease relied upon in this case the lessor's claim is fully matured and absolutely due and owing at the time the petition in bankruptcy was filed. The provision operated as a conditional limitation terminating the lease without entry or other action by the lessor. The obligation imposed upon the lessee by the clause to pay damages cannot be an obligation to pay rent, because the lease is gone. Rent reserved and covenants to pay rent do not survive the termination of the lease, yet this covenant becomes operative only upon the termination of the lease. The distinction between claims based on covenants to pay future rent and a claim based upon a promise by the lessee to pay

damages upon the termination of the lease *ipso facto* upon his going into bankruptcy is thus a vital one. The uncertainty that prevents a provable claim being founded on a covenant to pay *rent* is not found in a clause which operates to terminate the lease *ipso facto* as a conditional limitation and raises an obligation to pay *damages* for the reason that the uncertainty arises out of the technical law relating to rents, which therefore applies only to covenants to pay *rent*, and not to any other covenants, even though those covenants are intended to secure the lessor against loss of rents.

Lessors have tried various forms of special covenants in an attempt to give them a standing to prove their damages in the event of the lessee's bankruptcy. Two principal defects have been found by the courts in most of the covenants which have been used:

(1) They have been based upon a right of entry by the landlord.

(2) They have been indemnity covenants requiring the lessee to indemnify the lessor against actual loss suffered on reletting.

These defects caused the claim of the lessor to be uncertain both in obligation and amount at the time of filing the petition. It was uncertain at that time whether the lessor would elect to re-enter, and it was uncertain whether, if he did re-enter, he would suffer any loss. Since the covenant was to *indemnify* against actual loss, it was necessary to await the end of the term to determine it. These defects were fatal, since, as this Court stated in the Manhattan Properties case, *supra* (p. 338):

> "There can be no debt provable in bankruptcy arising out of a contract which becomes effective only at the claimant's option and after the inception of the proceedings, the fulfilment of which is contingent on what may happen from month to month or up to the end of the original term."

The clause upon which the present claim is based avoids both these difficulties. It operates, not on entry at the election of the lessor, but *ipso facto* as a conditional limitation immediately upon the filing of the petition in bankruptcy. Furthermore, it is not an *indemnity* covenant which requires awaiting the end of the term to ascertain actual loss, but a *damage* covenant which may be liquidated at a definite amount based only on facts readily determinable at the time of bankruptcy, viz., the rent reserved in the lease for the remainder of the term and the fair rental value of the premises at that time.

IV. The legislative history of the Bankruptcy Act in the light of the trend of court decisions shows that Congress intended the instant claim to be provable.

This Court in the Manhattan Properties case, *supra,* decided the general question of the provability of future rent claims in the absence of special covenants on a historical basis. The equitable considerations which it is possible to urge on both sides were reviewed, and it was conceded that a logical case could be made for provability. However, the question was reduced to an inquiry into the intent of Congress. Since the weight of the lower-court decisions had been heavily against the provability of such claims and Congress had amended the Bankruptcy Act many times without alteration of the section defining provable debts, it was held that the construction adopted by the courts had been acceptable to the legislative arm of the Government.

A similar analysis of the court decisions and dicta dealing with claims based on special covenants in leases as distinguished from simple covenants to pay rent leads to the conclusion that Congress intended claims based upon properly drawn covenants to be provable.

The historical foundation for the provability of damage claims against lessees based on ipso-facto covenants starts with the significant fact that no case has been found (other than the overruled decision of the District Court below) which holds not provable a claim based on a covenant substantially similar to the instant one. This is in direct contrast to the dozens of square holdings relied on by this Court in the Manhattan Properties case that future rent claims based on leases not containing such clauses are not provable.

On the other side, it must be admitted that there is a dearth of square holdings that claims based on ipso-facto damage clauses are provable. The only actual decision found (other than the decision below) is *In re Twentieth Century Millinery Exchange, Inc.*, 41 Fed. (2d) 237 (D.C. S.D. N.Y.). In this case the bankrupt leased from one Charles Ulin certain premises by a lease which provided that, if the lessee be adjudicated a bankrupt or if a petition in bankruptcy be filed by the lessee—

> "Such event shall be deemed to constitute a breach of this lease and thereupon, *ipso facto* and without entry or without other action by the lessor, this lease shall become and be terminated."

The bankrupt subleased to the claimant at a lower rental, the sublease containing a covenant that, if the bankrupt committed any breach of the original lease requiring the claimant to pay the full amount of rent reserved in the original lease, then the bankrupt should be obligated to pay the claimant the difference between the rent reserved in the original lease and that reserved in the sublease. The court held the claim provable under subdivisions 1 and 4 of the Bankruptcy Act, sec. 63 (a). Perhaps this decision may be limited to its special facts.

However, many of the leading decisions which established the non-provability of claims based on simple covenants to

pay rent or on special covenants not creating a certain obligation at the date of bankruptcy definitely indicate the manner in which covenants could be drawn so that the lessor would have a provable claim.

In *Ex Parte Lake*, Fed. Cas. 7991 (D. Mass. 1877), Judge Lowell held that even under the Act of 1867 the lessor had no provable claim under a covenant which provided that, upon re-entry by the lessor, the lessee—

> "* * * shall remain for the residue of said term responsible for the rent and taxes herein reserved, and shall be credited for such amounts only as shall be by the lessors actually realized."

However, Judge Lowell remarked significantly:

> "If the contract were a little different and provided merely that the lessees should pay any loss or damage consequent upon the diminished value of the premises, the amount would be capable of ascertainment with sufficient certainty. * * * But I am unable to reach the conclusion that the stipulation in this case is calculated to work out the result. It seems to provide that the lessees, after a breach shall remain liable for the rent precisely as before, excepting that they are to be credited with any sums actually received for the use of the premises. This brings the case unfortunately within the numerous decisions concerning rent, which, not accruing at once, cannot be estimated beforehand."

It requires little imagination to see that Judge Lowell was sympathetic with lessors whose claims were barred by the technical law relating to rent and that he would have held the claim provable if the covenant had been "a little different."

The leading early decision on the subject cited and relied upon in almost all subsequent cases dealing with the subject is *In re Roth & Appel,* 181 Fed. 667 (C.C.A. 2.). The claim in this case was based on a covenant which gave the lessor a right to re-enter on the bankruptcy of the lessee and recover the difference between the rent reserved and the rent which the lessor was actually able to obtain on reletting. The court held the claim not provable because of the uncertainty as to whether the lessor would re-enter and the uncertainty as to whether there would be a loss if he did. After discussing these defects the court said (p. 671):

> "Undoubtedly the parties to a lease may agree that bankruptcy shall terminate it, and that, upon such termination, all future installments of rent shall at once become due and payable. In such a case, the installments may be regarded as consolidated by the contract, or, perhaps, as falling due by way of penalty. *Not improbably claims based upon such leases are provable in bankruptcy.*" (Italics supplied.)

Could the court have more clearly indicated its belief that a provable claim could be founded upon a properly drawn covenant?

In *Kothe* v. *Taylor Trust,* 280 U.S. 224, the lease contained a clause as follows:

> "The filing of any petition in bankruptcy * * * by or against the Lessee shall be deemed to constitute a breach of this lease, and thereupon, *ipso facto* and without entry or other action by the Lessor, this lease shall become and be terminated; and, notwithstanding any other provisions of this lease the Lessor shall forthwith upon such termination be entitled to recover damages for such breach in an amount equal to the amount of the rent reserved in this lease for the residue of the term hereof."

The Referee and District Court disallowed the claim on the general ground that damages for the amount of unaccrued rent are not provable, but the Circuit Court held the claim allowable under section 63 (a) 4, of the Bankruptcy Act. In the Supreme Court the trustee argued that the claim was not allowable because the covenant required the payment of the full amount of the rent, and therefore was equivalent to the imposition of a penalty unrelated to the actual damage sustained by the lessor, since, if the claim were allowed, the lessor would get back his premises and also his rent.

The Supreme Court sustained this argument and reversed the court below *solely* on the ground that the provision for damages was unreasonable. It seems highly improbable that the Supreme Court would have decided the case on the ground that an improper measure of damages had been specified unless it felt that, but for the damage question, the claim was provable, particularly when the case had been decided below on the general question of the provability of the claim.

If Congress is chargeable with notice of the decisions of the courts expunging claims for future rents, it is likewise chargeable with notice of the clearly expressed dicta that the lessor could protect himself by using a clause substantially similar to the one used by the lessor in the instant case. There is not only no historical background of decisions adverse to the logically admissible construction of the statute contended for by the respondent, but the dicta and implications of the relevant decisions are favorable to that construction. The fact that Congress did not amend the Bankruptcy Act to change the construction clearly forecast by these court decisions, although the Act was many times amended in other respects, is persuasive that the judicial construction was acceptable to Congress.

B. & O. R. Co. v. *Baugh,* 149 U.S. 368, 372.

V. It is not contrary to the provisions of the Bankruptcy Act for parties to make a contract out of which a claim provable in bankruptcy may arise even though without the contract there would be no provable claim.

It would seem a waste of time of this Court to set forth such an obvious proposition but for the fact that the contrary is strenuously urged by the petitioner and *amici curiae.*

The petitioner states (p. 4) that the first question presented in this case is:

> "Can a landlord and tenant turn an otherwise non-provable claim into a provable claim merely by stipulating that, in the event of the bankruptcy of the tenant, the lease shall ipso facto terminate and the tenant thereupon be liable to pay liquidated damages?"

Similarly, point II of a brief filed by Walter E. Hope and H. Struve Hensel as *amici curiae* (p. 12) is:

> "The instant claim can not be made provable, contrary to the Bankruptcy Act, by an agreement between claimant and the bankrupt."

It is respectfully submitted that this form of stating the question at issue begs the question. Of course, if we start with the premise that the clause is contrary to the Bankruptcy Act, it cannot be made the basis of a provable claim. The question is simply whether, under section 63 of the Bankruptcy Act, respondent has a provable claim. There is no question of violating any provision of the Bankruptcy Act or of baldly stipulating that a non-provable claim should nevertheless be provable.

This argument in a circle is probably the result of failing to distinguish between claims for future rent and dam-

age claims based on special covenants, and therefore mistaking the scope and effect of the decision of this Court in the Manhattan Properties case.

The *amici curiae* on behalf of petitioner, referred to above, on page 15 of their brief endeavor to reduce the ipso-facto covenant in the instant case to an absurdity by stating that it is equivalent to a provision that—

> "In the event of the filing of a bankruptcy petition against the lessee, the lessor shall have a provable claim in the amount of $177,788."

The brief then proceeds with a series of questions, the burden of which is: "Can the parties stipulate what claims shall be provable or is the statute to define the types of provable claims?"

Obviously, the parties to a contract cannot write the Bankruptcy Law. But they can make a valid contract, the terms of which will create obligations which would not exist had the contract not been made and upon which a claim provable in bankruptcy may be based, although without the contract obviously there would have been no provable claim.

The parties to the lease involved in the instant case did not endeavor to alter section 63 of the Bankruptcy Act. They endeavored to create by contract an obligation which would be sufficiently certain in obligation and amount to fall within the terms of section 63. In doing this they followed the suggestions which had been made by Judge Lowell in *Ex Parte Lake, supra,* and by the Court of Appeals for the Second Circuit in *In re Roth & Appel, supra.*

In *Brown* v. *Irving Trust Company,* the companion case to the Manhattan Properties case, L. Hand, J., in delivering the opinion for the Court of Appeals, said (66 Fed. (2d) 473):

> "The claimant next argues that in case of bankruptcy it could not have been the purpose to reserve a claim or a series of claims in the future against a bankrupt corporation, and that for this reason the promise should be construed as one for liquidated damages. If the only condition of reentry had been bankruptcy, more could be said for this, though hardly enough in view of the terms chosen; but under this lease the lessor might reenter for any breach of covenant, and some of these might occur while the lessee was amply able to respond. If in those events the promise was to indemnify the lessee seriatim, or at the end of the term, we can not recast the condition to make them over into a liquidation of damages in the case of bankruptcy. *Possibly the full intent was not expressed; if so, the loss must fall upon the lessor, who presumably drafted it.*" (Italics supplied.)

Are the lessors who have been unable to prove claims for their losses on the bankruptcy of their lessees because of their faulty draftsmanship to be met, when they do succeed in drafting an efficient clause, with the charge that they are improperly subverting the Bankruptcy Act?

The contention that the parties in the instant case are merely endeavoring to stipulate that an unprovable debt shall be provable is set forth in a slightly different form in petitioner's brief, p. 20 ff., and supported by reference to the cases of *In re Wisconsin Engine Co.*, 234 Fed. 281, and *Atkins* v. *Wilcox*, 105 Fed. 595. These cases dealt with the provability in bankruptcy of claims based on unmatured notes. The notes in the Wisconsin Engine Co. case were given pursuant to a patent license agreement, while those in *Atkins* v. *Wilcox* were given for future rent. The claim based on the rent notes was held not provable and the claim based on the notes for royalties under the patent license

agreement was held provable. The court remarked in the Wisconsin Engine Co. case:

> "While the mere giving of notes to evidence or in prepayment of a clearly conditional obligation would not annul the condition or make an otherwise unprovable claim allowable in bankruptcy (Atkins v. Wilcox, 105 Fed. 595, 44 C. C. A. 626, 53 L. R. A. 118), the provision that notes should be given and that they should be negotiable is additional evidence tending to resolve any doubt as to the intention of the parties that the amount therein stated was to be payable in any event."

Petitioners go on to say (p. 22):

> "We submit that the signing of the notes was as much an express covenant to pay as the language contained in the lease at bar. Yet the test adopted in the two cases just cited was one of type and not of promise. Where there was not involved a non-provable type of claim, the promise contained in the notes was enforced. Where the case did involve a non-provable type, the promise was not enforced, the court pointing out in the Wisconsin Engine case that the giving of notes 'would not * * * make an otherwise unprovable claim allowable in bankruptcy' (p. 284)."

The petitioners in this argument neglect a vital part of the clause upon which the claim in the instant case is based. It includes not only a covenant to pay liquidated damages, but a provision for *ipso-facto* termination of the lease on bankruptcy. It is this conditional limitation which, by terminating the lease, removes the contingency in the obligation, *i.e.*, makes the covenant a promise to pay presently ascertainable damages, and not a covenant to pay rent.

Of course merely repeating a promise to pay rent, whether in the lease itself or on a separate piece of paper, would not create a provable claim. But that is not what the landlord and tenant did in this lease. They changed the *subject-matter* of the promise. When the bankruptcy petition was filed, liability under the covenant to pay *rent* ceased, and liability under the covenant to pay liquidated damages arose.

There is nothing improper about making a contract under which liability can arise only in event of bankruptcy. In the leading case of *Central Trust Co.* v. *Chicago Auditorium Association*, 240 U.S. 581, this Court held that bankruptcy constituted an anticipatory breach of contract to transport baggage, saying (p. 591):

> "In short, it must be deemed an implied term of every contract that the promisor will not permit himself, through insolvency or acts of bankruptcy, to be disabled from making performance; and, in this view, bankruptcy proceedings are but the natural and legal consequence of something done or omitted to be done by the bankrupt, in violation of his engagement" (240 U.S. at 591).

If the courts will *imply* a provision that the promisor will not go into bankruptcy, surely it is competent for the parties expressly to contract for liability conditioned upon the promisor going into bankruptcy.

VI. The covenant in the instant case liquidates the damages upon a footing that is familiar and fair.

The measure of damages specified in the lease is (R. 10):

> "* * * an amount equal to the amount of the rent reserved in this lease for the residue of the term

hereof less the fair rental value of the premises for the residue of said term."

The case of *William Filene's Sons Co.* v. *Weed et al.*, 245 U.S. 597, shows that there is no difficulty in computing the damages under a provision such as the one in the instant lease. In that case this Court permitted proof in receivership proceedings of a claim based upon a covenant by the lessee to pay the lessor as damages the difference between the rental value of the premises and the rent and other payments specified in the lease for the remainder of the term. The fact that this was a receivership instead of a bankruptcy case does not affect it as an authority for the proposition that damages for breach of the covenant in the instant case may readily be determined. Mr. Justice Holmes stated (p. 602):

> "The rest of the claim is for damages ultra the twenty thousand dollars a year—the difference between the rental value at the date of entry and the rent reserved, less the amount received under the twenty thousand dollar clause. This also was contracted for and we see no reason why it should not be paid. The contract was not that all the rent for the term should become presently due, it was not for rent at all, but was a personal covenant that liquidated the damages upon a footing that was familiar and fair."

There is no practical difficulty in reducing respondent's claim to dollars and cents. The liquidation of the claim involves the determination of only one fact—the fair rental value of the premises at the date of bankruptcy. The obvious and common way to make this determination is by means of the testimony of real-estate experts familiar with the property and similar properties. The property has been

leased again for a part of the remaining term. The rentals secured under this lease will provide very good evidence of the value of the entire term. Courts have in general found no difficulty in ascertaining the value of leaseholds. It is a common question arising in breach of contract and tax cases. See, for example:

Neal v. *Jefferson,* 212 Mass. 517.
Dodds v. *Hakes,* 114 N.Y. 260.
Williston on Contracts, vol. III, sec. 1405.
Henri Pauchey & Son, Inc., 22 B.T.A. 774.
Hotel Waldorf Co., 22 B.T.A. 430.
The Union Co. v. *United States* (Ct. Clms.), 46 Fed. (2d) 717.
Bowman Hotel Corporation, 24 B.T.A. 1193.

It has never been suggested that courts were unable to value estates in fee simple. It has been done on countless contract, tax and condemnation cases. Valuation of the fee is simply an estimate of the present value of all future fruits of ownership. Bankruptcy courts have no difficulty in doing this. *In re Marshall's Garage,* 63 Fed. (2d) 759. The valuation of leasehold is merely an estimate of the same thing for a shorter period.

Surely the bankruptcy court is not so impotent as to be unable to determine such a simple fact as the fair rental value of this property for the residue of the term. The problem is less difficult than the valuation of a cab privilege, which was required in *Central Trust Co.* v. *Chicago Auditorium,* 240 U.S. 581.

VII. The 1934 amendments to section 63 of the Bankruptcy Act have no tendency to show that prior to such amendments Congress intended that claims based on ipso-facto covenants should not be provable.

On June 7 and 18, 1934, section 63 of the Bankruptcy Act was amended by adding three new subdivisions, one of which is as follows:

> "* * * (7) claims for damages respecting executory contracts including future rents whether the bankrupt be an individual or a corporation, but the claim of a landlord for injury resulting from the rejection by the trustee of an unexpired lease of real estate or for damages or indemnity under a covenant contained in such lease shall in no event be allowed in an amount exceeding the rent reserved by the lease, without acceleration, for the year next succeeding the date of the surrender of the premises plus an amount equal to the unpaid rent accrued up to said date: Provided, That the court shall scrutinize the circumstances of an assignment of future rent claims and the amount of the consideration paid for such assignment in determining the amount of damages allowed assignee hereunder: Provided further, That the provisions of this clause (7) shall apply to estates, pending at the time of the enactment of this amendatory Act in which the time for filing such claims has not expired."

Petitioners and *amici curiae* in support of petitioners in their respective briefs argue that this amendment shows that prior to the amendment Congress intended that claims like the instant one should not be provable. The syllogism runs as follows:

Major premise: It was intended by Congress to change the then existing law by adding a new type of provable claim.

Minor premise: The instant type of claim is included within the definition of such new type of claim.

Conclusion: Therefore the instant claim was not provable prior thereto.

The difficulty with this line of reasoning again is that it fails to recognize, *as the 1934 amendment does,* the distinction between a claim for future rents, which the instant claim is not, and a claim for damages under a covenant in a lease. It is not necessary to resort to the Committee reports or complicated analysis to determine what new subsection (7) accomplishes. *First,* it adds a new type of claim —a claim for future rents as such which, prior to the amendment, was not provable, under the decision of this Court in the Manhattan Properties case. *Secondly,* it restricts the amount for which claims for future rents *and* claims for damages or indemnity under lease covenants may be allowed to a figure which does not exceed the rent reserved in the lease for the year succeeding the date of the surrender of the premises by the trustee.

It is submitted that the minor premise of the argument for petitioner is false. The instant claim is not included within the definition of the new type of claim. The instant claim could not be correctly included among "claims for damages respecting executory contracts including future rents." The contract upon which this claim is based is not executory at petition filed and the claim is not for future rents.

On the other hand, the instant claim (but for the proviso limiting the application of clause (7) to estates in which the time for filing claims had not expired) is included in the restriction limiting all claims by landlords, whether based on special covenants or not, to an amount not exceeding one year's rent. The difference in phraseology in the clause *permitting* a new type of claim and the clause *restricting* claims to an amount not exceeding one year's rent is highly

significant. The latter is obviously much broader than the former. If Congress had believed that all landlord's lease claims were covered by the permissive clause, it is submitted that the subject of the restrictive clause would not have been changed, and sub-section (7) would have been phrased substantially as follows:

> "(7) Claims for damages respecting executory contracts including future rents whether the bankrupt be an individual or a corporation but future rent claims shall in no event be allowed in an amount exceeding * * *," etc.

The intent of Congress obviously was to permit claims for future rents (which this Court had held in the Manhattan Properties case to be not provable) to be proved along with claims based on special damage covenants (which several courts had intimated or held to be provable), and to limit both to an amount which would not exceed one year's rent.

In this connection there is an apparent inconsistency in the *amici curiae* brief in support of petitioner filed by Walter E. Hope and H. Struve Hensel. After stating that Congress intended to exclude the instant claim from the category of provable claims, *amici curiae* add (p. 7):

> "Such conclusion is clear and is important not only in respect of this claim but in respect of future bankruptcies. If the instant claim is not expunged, it will have been construed as outside the scope of new clause (7) of Section 63a and, therefore, all landlords using the mystical language here used will prove their claims in full. The intent of Congress to limit such claims in the future to a comparatively small amount will thus be evaded."

Yet on page 31 of the same brief the following statement appears:

> "One more thing should be noted. If, perchance, the instant claim is not included within clause (7), it is not provable in this or any other bankruptcy, past or future."

It is submitted that the proper construction of new subsection (7) of section 63 is that the instant claim is not included in the permissive clause of that section, but is included in the restrictive clause. The decision in this case will therefore not affect future bankruptcies.

Conclusion.

The decision of the Circuit Court of Appeals correctly applies section 63 of the Bankruptcy Act to the instant claim, and should therefore be affirmed.

Respectfully submitted,

THOMAS HUNT,
EARLE W. CARR,
Amici Curiae.

SUPREME COURT OF THE UNITED STATES.

No. 22.—October Term, 1934.

Irving Trust Company, as Trustee in Bankruptcy of Outfitters Operating Realty Co., Inc., Petitioner,
vs.
A. W. Perry, Inc.

On Writ of Certiorari to the United States Circuit Court of Appeals for the Second Circuit.

[December 3, 1934.]

Mr. Justice Roberts delivered the opinion of the Court.

The respondent was lessor in a lease having a number of years to run at the date of the tenant's bankruptcy. The writing stipulated:

". . . for the more effectual securing to the Lessor of the rent and other payments herein provided, it is agreed as a further condition of this lease that the filing of any petition in bankruptcy or insolvency by or against the Lessee shall be deemed to constitute a breach of this lease, and thereupon, ipso facto and without entry or other action by the Lessor, this lease shall become and be terminated; and, notwithstanding any other provisions of this lease, the Lessor shall forthwith upon such termination be entitled to recover damages for such breach in an amount equal to the amount of the rent reserved in this lease for the residue of the term hereof less the fair rental value of the premises for the residue of said term."

Respondent filed a proof of claim, based upon this clause, which the referee expunged. The District Court affirmed the order. The Circuit Court of Appeals, reversing the decree of the District Court, directed that the claim should be allowed.[1] The case is here upon writ of certiorari.

Decision is to be made under Sections 1 (11) and 63 (a) and (b) of the Act of July 1, 1898, as they stood prior to the filing of the petition on September 30, 1932, and the presentation of respondent's proof of claim on March 29, 1933.[2] The subsequent amendments of June 7 and 18, 1934,[3] are by their terms inapplicable.

[1] 69 F. (2d) 90.

[2] U. S. C. Tit. 11, §§ 1 and 103.

[3] Public No. 296 and Public No. 387, 73d Congress.

In *Manhattan Properties, Inc.* v. *Irving Trust Company*, 291 U. S. 320, we reserved the question of the provability of a claim for liquidated damages arising upon such a covenant. The petitioner's contention is that inasmuch as claims for future rent, or for damages for the breach of the covenant to pay rent, or claims upon contracts of indemnity conditioned upon reentry by the landlord subsequent to bankruptcy, were there held not provable, it logically follows that a claim for stipulated damages for breach of the lease may not be proved. We hold otherwise.

By the terms of the contract the filing of the petition in bankruptcy was, of itself, and irrespective of the election of lessor or lessee, a breach of the lease. The claim of the landlord, consequent upon the breach, arose and matured at the moment of the filing of the petition. The claim is not for rent reserved or upon the lease as such, but is founded upon an independent express contract, and hence within the very words of Section 63 (a) 4.

The Circuit Court construed the stipulation as an agreement on the part of the tenant to pay as liquidated damages, in the event of the specified breach, an amount equal to the difference between the present fair value of the remaining rent due under the lease and the present fair rental value of the premises for the balance of the term. The covenant is fairly susceptible of this construction. So read, the court held the clause provided a reasonable formula for ascertaining the damages of the landlord, did not smack of a penalty, and was therefore enforceable. See *Wm. Filene's Sons Co.* v. *Weed*, 245 U. S. 597. We concur in the view that the contract, as its terms were interpreted and applied, supports a provable claim for the stipulated damages.

The judgment of the Circuit Court of Appeals is affirmed.

A true copy.

Test:

Clerk, Supreme Court, U. S.